STIC Scientific and Technical Information Center	Dialog®

Core FT1:

- Business & Industry , File 9 (1994 - present)
- ABI/INFORM®, File 15 (1971 - present)
- Gale Group PROMT®, File 16 (1990 - present)
- Gale Group PROMT®, File 160 (1972-1989)
- Gale Group Trade & Industry Database , File 148 (1976 - present)
- Gale Group Computer Database , File 275 (full-text 1/1988 - present)
- Business Wire, File 610 (Mar 1999 - present)
- Business Wire, File 810 (1986 - February 1999)

Core FT2:

- Dialog Global Reporter, File 20 (May 1997 - present)
- The McGraw-Hill Companies Publications Online, File 624 (1985 - present)
- Gale Group New Product Announcements/Plus® (NPA/Plus, File 621 (1985 - present)
- Gale Group Newsletter Database , File 636 (1988 - present)
- PR Newswire, File 613 (May 1999 - present)
- San Jose Mercury News, File 634 (Jun 1985 - present)
- PR Newswire, File 813 (May 1987 - May 1999)

Sub35FT:

- McClatchy-Tribune Information Service, File 608 (Jan 1989 - present)
- American Banker Financial Publications, File 625 (1981 - June 2008)
- Banking Information Source, File 268 full-text (1994 - present)
- Bond Buyer Full Text, File 626 (November 1981 - April 2008)
- DIALOG Finance & Banking Newsletters, File 267 (1996 - present)

Set#	Query
L1	SEGREGATED WITH ACCOUNT
L2	sub adj2 account$3
L3	segrgat$2 with account$3

L4	segregat$2 with account$3
L5	owner ownership
L6	COMPAN$3
L7	organization$2
L8	enterprise enterprize
L9	nonvoting with stock
L10	((investment with discretion) with (gains proceeds profit$1)) with share$1

54/9/1 (Item 1 from file: 148)
10401607 **Supplier Number:** 21022983
SEC expands performance-fee requirements.(Securities and Exchange Commission)

Anand, Vineeta
Pensions & Investments , v26 , n16 , p51(1)
August 10 , 1998
ISSN: 1050-4974
Language: English
Record Type: Abstract

Abstract: The Securities and Exchange Commission has expanded the category of investors that investment advisers can charge performance-related fees. The definition of qualified purchasers that investment advisers can charge performance-related fees is now pools whose investors have minimum assets of $5 million each. The broadening of the category gives **investment** advisers wider **discretion** to charge fees either on a **share** of the appreciation of an **investment**'s capital or on capital **gains**.
Industry Codes/Names: BUSN Any type of business; INSR Insurance and Human Resources
Descriptors: United States. Securities and Exchange Commission--Laws, regulations, etc.; Investment advisers--Laws, regulations, etc.; Securities law--Management
Product/Industry Names: 6282000 (Investment Advisers); 6201000 (Securities Investment Advisers); 9108623 (Trading Regulations)
Product/Industry Names: 6282 Investment advice
File Segment: TI File 148

54/9/2 (Item 2 from file: 810)
0776527 BW0235

SIMULATION SCIENCES INC **:** Simulation Sciences Announces Completion of Follow-On Stock Offering

November 20, 1997

Ticker Symbol: SMCI
Byline: Business/Technology Editors & Chemicals/Energy/Environmental
Dateline: BREA, Calif.
Time: 11:08 PT

Word Count: 414

Writers

BREA, Calif.--(BUSINESS WIRE)--Nov. 20, 1997--Simulation Sciences Inc. ("SIMSCI" or the "company") (Nasdaq:SMCI) Thursday announced a public offering of 2,700,000 shares of common stock, of which 2,586,818 will be sold by SIMSCI and 113,182 will be sold by certain stockholders of the company.

SIMSCI has also granted to the underwriters a 30-day option to purchase up to 405,000 additional shares of common stock solely to cover over-allotments, if any.

The managing underwriters for the offering are BT Alex. Brown Inc.; Wessels, Arnold & Henderson LLC; and SoundView Financial Group Inc.

SIMSCI expects to use the net proceeds from the offering for general corporate purposes and working capital, including continued investments in product development and expansion of sales and marketing activities.

The company has not yet identified specific uses for such **proceeds** and will have **discretion** over their use and **investment**.

The company will not receive any of the net **proceeds** from the sale of the **shares** by the selling stockholders.

Copies of the prospectus may be obtained from:

BT Alex. Brown Inc.
One South St.
Baltimore, Md. 21022
Tel: 410/727-1700

Wessels, Arnold & Henderson LLC
601 Second Ave. South, Suite 3100
Minneapolis, Minn. 55402-4314
Tel: 612/373-6100

SoundView Financial Group Inc.
22 Gatehouse Rd.
Stamford, Conn. 06911-0236
Tel: 203/462-7200

About SIMSCI

Simulation Sciences is a leading provider of commercial application software and related services to the petroleum, petrochemical, industrial chemical and other process industries as well as the engineering and construction firms that support those industries.

SIMSCI's software products are designed to increase customers' profitability by reducing their capital investment costs, increasing yields, improving product quality and enhancing management decision making.

SIMSCI maintains offices in Brazil, Egypt, Germany, Japan, Singapore, the United Kingdom, the United States and Venezuela, and provides support and service to more than 650 customers in more than 65 countries. For more information about SIMSCI, visit the SIMSCI Web site at http://www.simsci.com .

This news release shall not constitute an offer to sell or the solicitation of an offer to buy nor shall there be any sale of these securities of any state in which such offer, solicitation, or sale would be unlawful prior to registration or qualification under the securities laws of any such state.

CONTACT: Simulation Sciences Inc.
Bryce Betteridge, 253/564-6887
e-mail: bbetteridge@simsci.com

KEYWORD: CALIFORNIA MARYLAND MINNESOTA CONNECTICUT
INDUSTRY KEYWORD: CHEMICALS/PLASTICS COMPUTERS/ELECTRONICS ENERGY ENVIRONMENT OIL/GAS BIOTECHNOLOGY MINING ENMED

Today's News On The Net - Business Wire's full file on the Internet
with Hyperlinks to your home page.
URL: http://www.businesswire.com
>

54/9/3 (Item 3 from file: 16)
05310536 **Supplier Number:** 48083535

Simulation Sciences Announces Follow-On Stock Offering.
Business Wire , p 10290414
Oct 29 , 1997
Language: English **Record Type:** Fulltext
Document Type: Newswire ; Trade
Word Count: 454

Text:

BREA, Calif.--(BUSINESS WIRE)--Oct. 29, 1997--Simulation Sciences Inc. ("SIMSCI" or the "Company") (Nasdaq:SMCI) Wednesday announced that it has filed a registration statement with the Securities and Exchange Commission relating to the proposed underwritten public offering of 2,600,000 shares of common stock, of which 2,500,000 will be sold by SIMSCI and 100,000 will be sold by certain stockholders of the Company.

SIMSCI has also granted to the underwriters a 30-day option to purchase up to 390,000 additional shares of common stock solely to cover over-allotments, if any.

The managing underwriters for the offering will be BT Alex. Brown Inc.; Wessels, Arnold & Henderson L.L.C.; and SoundView Financial Group Inc.

SIMSCI expects to use the net proceeds from the offering for general corporate purposes and working capital, including continued investments in product development and expansion of sales and marketing activities. The Company has not yet identified specific uses for such **proceeds** and will have **discretion** over their use and **investment**. The Company will not receive any of the net **proceeds** from the sale of the **shares** by the selling stockholders.

When available, a copy of the preliminary prospectus may be obtained from:

BT Alex. Brown Inc. Wessels, Arnold & Henderson L.L.C. One South Street 601 Second Ave. South, Suite 3100 Baltimore, MD 21022 Minneapolis, MN 55402-4314 Tel: 410-727-1700 Tel: 612-373-6100

SoundView Financial Group Inc. 22 Gatehouse Road Stamford, CT. 06911-0236 Tel: 203-462-7200

A registration statement relating to these securities has been filed with the Securities and Exchange Commission but has not yet become effective. These securities may not be sold nor may offers to buy be accepted prior to the time the registration statement becomes effective.

This communication shall not constitute an offer to sell or the solicitation of an offer to buy nor shall there be any sale of these securities in any state in which such offer, solicitation or sale would be unlawful to registration or qualification under the securities laws of any such state.

About SIMSCI

Simulation Sciences is a leading provider of commercial application

software and related services to the petroleum, petrochemical, industrial chemical and other process industries as well as the engineering and construction firms that support those industries.

SIMSCI's software products are designed to increase customers' profitability by reducing their capital investment costs, increasing yields, improving product quality and enhancing management decision making. SIMSCI maintains offices in Brazil, Egypt, Germany, Japan, Singapore, the United Kingdom, the United States and Venezuela, and provides support and service to more than 650 customers in over 65 countries.

For more information about SIMSCI, visit the SIMSCI Website at http://www.simsci.com

CONTACT: Simulation Sciences Inc.
Bryce Betteridge, 253/564-6887
Internet: bbetteridge@simsci.com

Publisher Name: Business Wire
Company Names: *Simulation Sciences Inc.
Event Names: *810 (Securities issued, listed)
Geographic Names: *1USA (United States)
Product Names: *7372400 (Applications Software)
Industry Names: BUS (Business, General); BUSN (Any type of business)
NAICS Codes: 51121 (Software Publishers)
Special Features: COMPANY

54/9/4 (Item 4 from file: 16)
05290740 **Supplier Number:** 48056537

Security Dynamics Technologies Inc. Commences Public Offering of 3,000,000 Shares of Common Stock
PR Newswire , p 1016NETH011
Oct 16 , 1997
Language: English **Record Type:** Fulltext
Document Type: Newswire ; Trade
Word Count: 343

Text:

BEDFORD, Mass., Oct. 16 /PRNewswire/ -- Security Dynamics Technologies Inc. (Nasdaq: SDTI) today announced the commencement of its public offering of 3,000,000 shares of Common Stock at a price of $39.50 per share. The transaction includes 1,176,000 shares being offered by the Company and 1,824,000 shares being offered by selling stockholders, including 1,348,206 shares issued to certain selling stockholders on July 15, 1997 in conjunction with the acquisition by the Company of DynaSoft AB.

The offering is being managed by BT Alex. Brown Incorporated, BancAmerica Robertson Stephens and Cowen & Company.

The Company expects to use the net proceeds from the offering for

general corporate purposes, including possible acquisitions. The Company has not as yet identified specific uses for such **proceeds** and will have **discretion** over their use and **investment**.
The Company will not receive any of the net **proceeds** from the sale of **shares** by selling stockholders.

Security Dynamics is the leading provider of enterprise network and data security solutions. Security Dynamics' products help organizations conduct business securely, protect corporate information assets and facilitate business-to-business and business-to-consumer electronic commerce.

A copy of the prospectus may be obtained from:

BT Alex. Brown Incorporated
1 South Street
Baltimore, MD 21202
Tel. 410-727-1700

or

BancAmerica Robertson Stephens
555 California Street, Suite 2600
San Francisco, CA 94104
Tel. 415-781-9000

or

Cowen & Company
One Financial Square
New York, NY 10005
Tel. 212-495-6000

This communication shall not constitute an offer to sell or the solicitation of an offer to buy nor shall there be any sale of these securities in any jurisdiction in which such an offer, solicitation or sale would be unlawful prior to the registration or qualification under the securities laws of any such jurisdiction.

SOURCE Security Dynamics Technologies Inc.

-0- 10/16/97

/CONTACT: Marian O'Leary, Chief Financial Officer of Security Dynamics Technologies, 617-687-7733/

(SDTI)

CO: Security Dynamics Technologies Inc.; BT Alex. Brown Incorporated; BancAmerica Robertson Stephens; Cowen & Company
ST: Massachusetts
IN: CPR
SU: OFR

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5445 10/16/97 08:28 EDT http://www.prnewswire.com

Publisher Name: PR Newswire Association, Inc.

Company Names: *Security Dynamics Technologies Inc.
Event Names: *810 (Securities issued, listed)
Geographic Names: *1USA (United States)
Product Names: *3662300 (Intercom, Signal & Alarm Eqp)
Industry Names: BUS (Business, General); BUSN (Any type of business)
NAICS Codes: 33429 (Other Communications Equipment Manufacturing)
Ticker Symbols: SDTI
Special Features: COMPANY

54/9/5 (Item 5 from file: 810)
0755430 BW1503

INDUSTRI MATEMATIK INTL **:** Industri-Matematik International Announces Follow-On Stock Offering

October 07, 1997

Ticker Symbol: IMIC
Byline: Business Editors
Dateline: STOCKHOLM, Sweden
Time: 14:43 PT
Word Count: 555

STOCKHOLM, Sweden--(BUSINESS WIRE)--October 7, 1997--

Industri-Matematik International Corp. ("IMI" or the "Company"; NASDAQ-NM Symbol: IMIC), today announced that it has filed a registration statement with the Securities and Exchange Commission relating to the proposed underwritten public offering of 7,075,000 shares of common stock, of which 3,500,000 will be sold by IMI and 3,575,000 will be sold by certain stockholders of the Company. IMI and one of the selling stockholders have granted to the underwriters a 30-day option to purchase up to 1,061,250 additional shares of common stock solely to cover over-allotments, if any.

The managing underwriters for the offering will be BT Alex. Brown Incorporated, Deutsche Morgan Grenfell Inc., SoundView Financial Group, Inc, and UBS Securities LLC.

IMI expects to use the net proceeds from the offering for general corporate purposes and working capital, including the expansion of the Company's sales, support, service and marketing organizations. The Company has not yet identified specific uses for such **proceeds** and will have **discretion** over their use and **investment** . The Company will not receive any of the net **proceeds** from the sale of the **shares** by the selling stockholders.

When available, a copy of the preliminary prospectus may be obtained from:

BT Alex. Brown Incorporated	or
One South Street	Austin Friars House
Baltimore, MD 21202	2-6 Austin Friars
Tel: 410-727-1700	London EC2N 2HE, England
	Tel: (44)(171) 786-7444
Deutsche Morgan Grenfell Technology Group	or
1550 El Camino Real, Suite 100	6 Bishopsgate
Menlo Park, CA 94025	London, EC2N 4DA, England

```
Tel:  650-614-5000                          Tel:  (44)(171) 545-6239
SoundView Financial Group
22 Gatehouse Road
P.O. Box 110 236
Stamford, CT  06911-0236
Tel:  203-462-7200
UBS Securities                              or
555  California Street                      100  Liverpool Street
Suite  4650                                 London  EC2M  2RH, England
San Francisco, CA  94104                    Tel:  (44)(171) 901-1561
Tel:  415-352-5500
```

A registration statement relating to these securities has been filed with the Securities and Exchange Commission but has not yet become effective. These securities may not be sold nor may offers to buy be accepted prior to the time the registration statement becomes effective. This communication shall not constitute an offer to sell or the solicitation of an offer to buy nor shall there be any sale of these securities in any state in which such offer, solicitation or sale would be unlawful to registration or qualification under the securities laws of any such state.

About Industri-Matematik International

IMI develops, markets and supports software that enables manufacturers, distributors, wholesalers and retailers to more effectively fulfill their customers' orders. The Company's demand chain management solution, System ESS, provides the execution of multiple order fulfillment processes, including order management, distribution management, inventory replenishment and demand planning. System ESS has been designed specifically to meet the complex and high-volume demand chain management requirements of manufacturers, distributors, wholesalers and retailers, enabling them to better match product flow to actual customer demand, thereby enhancing revenue opportunities and reducing administrative and logistics/distribution costs.

Additional information about IMI can be found at the Company site on the World Wide Web at http://www.im.se.

```
    CONTACT: Industri-Matematik International
             Stig Durlow, email: stdu@im.se
             Lars-Goran Peterson, email: lgpe@im.se
             phone: +46 8 676 5000
                 -OR-
             IR Agency Contact:
             Lippert/Heilshorn & Associates
             John Heilshorn, email: john@lhai.com
             phone: 212-838-3777, ext. 104
    KEYWORD: NEW YORK
    INDUSTRY KEYWORD: COMPUTERS/ELECTRONICS COMED
Today's News On The Net - Business Wire's full file on the Internet
                          with Hyperlinks to your home page.
                          URL: http://www.businesswire.com
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54/9/6 (Item 6 from file: 16)
05219163 **Supplier Number:** 47960967

Security Dynamics Technologies Inc. Files Registration Statement With Respect to Public Offering of 2,500,000 Shares of Common Stock
PR Newswire , p 905NEF011

Sept 5 , 1997
Language: English **Record Type:** Fulltext
Document Type: Newswire ; Trade
Word Count: 551

Text:

BEDFORD, Mass., Sept. 5 /PRNewswire/ -- Security Dynamics Technologies Inc. (Nasdaq: SDTI) today announced that it has filed a Registration Statement with the Securities and Exchange Commission with respectto a proposed underwritten public offering of 2,500,000 shares of Common Stock. Of these shares, 676,000 are being offered by the Company and 1,824,000 are being offered by certain selling stockholders. In addition, the Company has granted the Underwriters an option to purchase up to an additional 375,000 shares of Common Stock to cover over-allotments, if any.

The offer is being managed by BT Alex. Brown Incorporated, Robertson, Stephens & Company LLC and Cowen & Company.

The Company expects to use the net proceeds from the offering for general corporate purposes, including possible acquisitions. The Company has not as yet identified specific uses for such **proceeds** and will have **discretion** over their use and **investment**.
The Company will not receive any of the net **proceeds** from thesale of **shares** by selling stockholders.

On August 22, 1997, the Company filed a Registration Statement with the Securities and Exchange Commission with respect to 396,387 issued and outstanding shares of Common Stock on behalf of certain selling stockholders. These shares were issued to the selling stockholders on July 15, 1997 in connection with the acquisition by the Company of DynaSoft AB, a company based in Sweden offering a range of security solutions, including secure single sign-on (SSSO) solutions, through its BoKS product family. The selling stockholders have advised the Company that they propose to sell, from time to time, all or part of the shares on the Nasdaq National Market at market prices prevailing at the time of sale, at prices related to such market prices or at negotiated prices. The Company will not receive any of the net proceeds from the sale of shares by the selling stockholders.

Security Dynamics is the leading provider of enterprise network and data security solutions. Security Dynamics' products help organizations conduct business securely, protect corporate information assets and facilitate business-to-business and business-to-consumer electronic commerce.

When available, a copy of the preliminary prospectus relating to the underwritten offering may be obtained from:

BT Alex. Brown Incorporated
1 South Street
Baltimore, MD 21202
Tel. 410-727-1700

or

Robertson, Stephens & Company LLC
555 California Street, Suite 2600
San Francisco, CA 94104
Tel. 415-781-9000

or

Cowen & Company
One Financial Square
New York, NY 10005
Tel. 212-495-6000

A registration statement relating to these securities has been filed with the Securities and Exchange Commission but has not yet become effective. These securities may not be sold nor may offers to buy be accepted prior to the time the registration statement becomes effective. This communication shall not constitute an offer to sell or a solicitation of an offer to buy nor shall there be any sale of these securities in any jurisdiction in which such an offer, solicitation or sale would be unlawful prior to the registration or qualification under the securities laws of any such jurisdiction.

SOURCE Security Dynamics Technologies Inc.

-0- 9/5/97

/CONTACT: Marian O'Leary, Chief Financial Officer of Security Dynamics Technologies Inc., 617-687-7733/

(SDTI)

CO: Security Dynamics Technologies Inc.; BT Alex. Brown Incorporated; Robertson, Stephens & Company LLC; Cowen & Company
ST: Massachusetts
IN: CPR
SU: OFR

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7657 09/05/97 16:24 EDT http://www.prnewswire.com

Publisher Name: PR Newswire Association, Inc.
Company Names: *Security Dynamics Technologies Inc.
Event Names: *810 (Securities issued, listed)
Geographic Names: *1USA (United States)
Product Names: *3662300 (Intercom, Signal & Alarm Eqp)
Industry Names: BUS (Business, General); BUSN (Any type of business)
NAICS Codes: 33429 (Other Communications Equipment Manufacturing)
Ticker Symbols: SDTI
Special Features: COMPANY

54/9/7 (Item 7 from file: 810)
0655105 BW0347

CALPERS 2 : CalPERS approves new real estate asset strategy, will solicit new management bids

December 16, 1996
Byline: Business Editors
Dateline: SACRAMENTO, Calif.

Time: 18:24 PT
Word Count: 626

SACRAMENTO, Calif.--(BUSINESS WIRE)--Dec. 16, 1996--The California Public Employees' Retirement System (CalPERS) Board of Administration today signed off on a new strategic plan for its $4.2 billion core real estate portfolio, which includes a decision to conduct a nationwide search for firms that will help CalPERS maximize the return on its real estate portfolio.

The strategic plan, developed by the senior investment officer - real estate, David Gilbert, calls for only minor changes in the composition of the core portfolio; but it includes a significantly different approach in the management of the portfolio, which consists of apartment, retail, industrial and office properties.

The plan re-organizes the portfolio into property types and geographic regions of the country. Each firm chosen will be responsible for managing the existing portfolio, for making new investments in the particular property type and region, and have greater **discretion** than **previously** before for buying and managing properties.

Firms will dedicate a **team** of **investment** professionals to **work** exclusively for CalPERS. Firms must be willing to **better** align interests and will be asked to consider co-investing and incentive fee structures.

The program calls for 25 to 40 percent of its core real estate assets to be invested in office properties, 20 to 35 percent in the retail sector, 15 to 25 percent in industrial properties and 10 to 20 percent in apartments.

About 25 to 50 percent of the core portfolio will be invested in the West, 15 to 30 percent will be invested in the South, 15 to 30 percent in the East, and 10 to 25 percent in the Midwest.

The management selection process will begin with a series of requests for proposals by property type, to begin in early 1997 and to be completed by the end of the year. This approach makes it easier for CalPERS to select managers based on expertise in specific areas.

The board also approved the strategy for the apartment portfolio and is expected to consider strategies for other of the remaining sub-portfolios over the next several months.

"The real estate strategic plan approved today is a blueprint for effective real estate management now and into the 21st century," said William D. Crist, president of CalPERS board of administration. "It gives us the opportunity to attract the best and the brightest real estate professionals to help us grow this important asset class, while increasing our chances for the very best strategic alliances."

Charles P. Valdes, investment committee chair, agreed. "The key objective of this approach is to maximize alignment of interests between CalPERS and the management teams we select to manage these assets, and to create an environment where responsibility and accountability are crystal clear. I believe this is the recipe for the next century in the real estate market," he said.

The new strategy is the second major asset class strategy approved by the board in recent months. Several months ago, it signed off on a strategy for consolidating its private equity programs. Today, the board approved a request for proposal (RFP) to obtain consultants for this asset class. The RFP is expected to be issued in January 1997 and targeted for completion by July 1997.

Existing alternative and private equity investment consultant contracts with Pacific Corporate Group and Hamilton Lane Advisors

will be extended through Sept. 30, 1997.
The real estate portfolio represents 5.7 percent of the $107 billion asset portfolio. Core office, retail, industrial and apartment properties represent $4.2 billion, with the remaining $1.9 billion devoted to specialized assets such as timber, housing, land and other specialized programs.
CalPERS provides retirement and health benefits to more than one million current and retired public employees and their families.

CONTACT: California Public Employees' Retirement System
Brad Pacheco/Pat Macht, 916/326-3991
KEYWORD: CALIFORNIA
INDUSTRY KEYWORD: REAL ESTATE BANKING

54/9/8 (Item 8 from file: 148)
08924022 **Supplier Number:** 18476217 (THIS IS THE FULL TEXT)
A gradual approach. (reforms in state-owned firms in China)

Liu, Lili
China Business Review , v23 , n3 , p19(6)
May-June , 1996
ISSN: 0163-7169
Language: English
Record Type: Fulltext; Abstract
Word Count: 4077 **Line Count:** 00330

Abstract: The Chinese government has adopted a slow and gradual approach in its efforts to reform state-owned enterprises (SOEs). Reforms made in 1978 provided SOEs with limited autonomy in managing financial benefits. 1983 reforms focused on the creation of a competitive environment for SOEs. A major reform was made in 1993 when SOEs were transformed into shareholding firms. These efforts should be maintained to make SOEs effectively compete against private firms.

Text:

Through trial and error, China's State enterprise reforms plot slow but steady progress

In 1978, China put reform of the State-owned enterprise (SOE) sector at the core of its ambitious economic reform program. The objectives were clear: to eliminate State bureaucratic control of management, instill accountability for profits and losses, and improve efficiency. The means to achieve these goals were less clear, however. Over the past 18 years, China's leadership has taken a slow but gradual approach in its quest to transform State enterprises into modern, efficient companies. The various reforms instituted to date have yet to complete the transformation of China's SOEs into fully marketized corporate entities, but have laid important groundwork for the long-term transformation of the SOE sector.
The leadership's gradual approach recognized the difficulties the reforms would have to tackle. Decades of central planning left China with a huge and deeply troubled SOE sector. In 1978, SOEs (not including collectives) accounted for close to 80 percent of industrial output and 80 percent of urban and town employment. Since the various government agencies

controlling an SOE could not possibly know every aspect of production, the planning process was driven by bargaining among State agencies and the SOE. This led to inefficiency and waste, duplication of investment projects, and stagnated technology. Managers and workers had little incentive to improve efficiency. Enterprises were eating from the same big pot (daguofan), regardless of how much they put in.

The first steps

The initial reform efforts that began in 1978 aimed at granting SOEs limited management autonomy and financial benefits. Sichuan Province was the first to experiment, followed by other trial efforts elsewhere. Under these experiments, firms would be allowed to **share** profits with the State after plan targets were met. The retained **profits** could be used, according to specified ratios, at the firm's **discretion** for **investment** and for bonuses to stimulate workers' efforts. SOEs under the experiment also enjoyed some freedom to make decisions about marketing and production, but were still responsible for meeting plan targets.

A number of problems and conflicts soon developed from these early experiments. Conflicts arose between the small part of the system that was being reformed and the rest of the unreformed institutional structure. For example, SOEs participating in the trial reforms found it hard to market their products, as State monopolies remained in control of marketing channels. Enterprises could not trim operating costs by laying off redundant workers, as employment was controlled by local labor bureaus. Moreover, a firm's profitability might not relate to management efforts because of the existence of large price distortions. Plan targets and input allocations also hampered the manager's freedom to make production decisions. These constraints on managerial freedom created new opportunities for managers to bargain with the State. The decentralization of power turned into a struggle to gain maximum benefits. This, in turn, resulted in virtually no transparency, as formulas for profit retention varied across firms within the same industry, across industries, and across regions.

The next phase

In 1983, the SOE reforms were expanded to focus on taxation, pricing, and planning, with the goal of creating a more open and competitive environment for all SOEs. Li-Gai-Shui was launched to change the profit retention system to a system of taxing income and product. In 1984, "The Decisions by the CCP on Economic Reforms" called for moving China's economy away from a mandatory plan toward a guidance plan, so that the market would play a greater role in resource allocation. This was supported by policies to increase further the role of the non-SOE sector, such as collective and town and village enterprises (TVEs), and to expand foreign investment and SOE-private enterprise partnerships.

By instituting more uniform tax rates in lieu of profit sharing, Li-Gai-Shui attempted to minimize the bargaining that accompanied the profit retention system and help break down the control State agencies had over SOEs. Further, Li-Gai-Shui was intended to correct the impact of the distorted price structure. The new system also was motivated by the pressure of declining central revenues, largely a result of the profits retained by local governments and enterprises.

Li-Gai-Shui was implemented in two stages. The first step began in 1983, when income taxes were levied on SOEs, with after-tax profits divided into funds the enterprise could retain and funds to be remitted to the State. The second step, begun in late 1984, was aimed at the gradual introduction of a complete tax system. Of particular importance to SOEs were the product tax and the adjustment tax. Profit differentials across SOEs were partly due to the distorted price structure. For example,

depending on their use of subsidized energy and raw materials, some SOEs stood to enjoy greater profits than other enterprises. A product tax was thus levied with differential rates on different industrial product groups. Products viewed as having higher profits due to distorted output/input prices were taxed more heavily than products viewed as having lower profits. An adjustment tax was further levied on about a quarter of SOEs with higher profitability, aimed at further reducing profit differentials caused by price distortions.

Using discretionary administrative intervention to put all SOEs on an equal footing proved inherently unworkable, however. In reality, the adjustment tax ended up being firm-specific, leaving negotiations to be settled on a case-by-case basis. Loss-making firms generally were able to avoid paying taxes, while profit-making firms were taxed heavily. Though the deficiencies of the adjustment tax were recognized, the tax was regarded as a compromise step between reality and broader reforms.

Li-Gai-Shui was not an isolated experiment, but part of a wider movement toward increased reliance on market forces. Price adjustments and reforms, an integral part of the move to greater marketization, began in 1978 with the State adjusting prices for goods in particularly short supply, including agricultural products, raw materials, and energy. By 1984, prices for producer goods outside the mandatory plan were allowed to float within a 20 percent margin. Recognizing that sudden price shocks across the market would prove disastrous, the government in 1985 adopted a dual-pricing system, which would prove to be one of the hallmarks of the Chinese reforms. Output within plan targets was to be sold at planned prices, but firms that fulfilled their plan targets were allowed to sell excess production at market prices. Plan targets were gradually reduced and the scope of market-determined prices was expanded. By 1993, market-determined prices accounted for 95 percent of total retail sales, 85 percent of capital goods and materials, and 90 percent of agricultural products. Only 5 percent of total industrial output was subject to mandatory planning.

Meanwhile, a series of proclamations issued since the mid-1980s further expanded the management autonomy of enterprises. These were codified into the Enterprise Law of 1988. In 1992, the State Council issued the implementing regulations to the Enterprise Law, which explicitly provided for noninterference by the government in the operations of State enterprises.

A new search

In the mid-1980s, SOE reform efforts ignited new and deeper debates on the issue of separating the State from the management of SOEs. By this time, the problems of the partial reforms were evident. Although by mid-1987 the central mandatory plan for industrial production covered only 20 percent of output, many lower levels of government continued to increase mandatory targets. Profit retention and Li-Gai-Shui turned into an exacerbated bargaining process and SOEs competed for financial benefits and concessions from the State. Moreover, investment, wage funds, and consumption expanded rapidly, pushing up price levels beginning in late 1984. The expansion was recognized by many in China to be a result of the weak financial discipline imposed on SOEs, as well as the poorly defined property rights of the State sector.

The search intensified for an appropriate management and incentive structure between the State and firm management so that the new autonomy of SOEs would be directed toward improving efficiency, rather than competing for financial benefits. The country experimented with various models, including the capital asset management responsibility system, share-holding, and the contract responsibility system (CRS). Of these experiments, the CRS expanded most rapidly and by 1988 had been adopted by the majority of SOEs.

The basic principle of the CRS was a contract between an SOE and the government for delivery of a lump-sum tax payment for a set time period. Once the contract was signed, the government was to separate itself from

management decisions about production and the SOE's managers were to be held responsible for fulfilling the contract. Profits in excess of the tax payment became the discretionary earnings of the firm. Beijing hoped that the new system would stabilize central tax revenues through fixed-term contracts with firms.

But the implementation of the CRS, too, quickly encountered a number of problems. The process of reaching agreement on the contract resulted in heavy bargaining over the firm's tax base, subsequent tax increases, and other contract terms. Tax and finance bureaus, banks, and other institutions with a stake in the SOE all sought to bargain for their own position. For example, while the SOE would be interested in decreasing its tax base, the finance bureau would seek to maximize tax payments and reduce debt service, which was tax deductible; and the bank's primary concern was that its loans be repaid. As a result, contracts were not uniform, but depended on the actors and their clout.

The short-term nature of the contracts also proved problematic. With contracts usually running just one to five years, there was little incentive for SOEs to make long-term investments. The government had to compel SOEs to invest by obliging some firms to reinvest a certain percentage of their retained earnings. Contract monitoring and enforcement were weak, as contracts tended to be enforced primarily for profitable firms but only minimal penalties were levied on those that failed.

The long road

The accumulated effects of the first decade of reforms have substantially altered the environment in which SOEs operate, but the economic performance of the SOE sector has been less satisfactory than expected. Several studies conclude that SOE productivity growth is lower than that of TVEs or collectives, which do not enjoy the preferential treatment given to SOEs, such as government subsidies, soft loans, and guaranteed cheap materials (especially oil and electricity), and must survive on their own in the market or perish. Even more telling, industrial-sector SOEs averaged 7.8 percent real annual output growth between 1980-92, compared to 18.4 percent for collectives, 64.9 percent for small private firms, and 37.2 percent for "others," a category which includes medium-sized and large private firms, joint ventures, and wholly foreign-owned firms. Over the reform period, the SOE contribution to industrial output decreased from around 80 percent in 1978 to less than 40 percent in 1994.

In some instances, the SOE reforms have yet to yield the intended results. The reforms have greatly increased managers' profit motives, for example, but in many cases SOE managers have to weigh expected payoffs from seeking maximum profit against conflicting pressures from government supervisory agencies (particularly at the local level) and from workers. Some managers, for example, put the welfare of their workers first, using earnings to finance wage increases rather than capital improvements. Others forge complex relationships with local governments, relying on local subsidies to sustain loss-making production, which add to the total value of output and turnover tax at the local level. In turn, the firm serves as a reimbursement bank for the local government's extraneous expenditures on such things as banquets.

While management autonomy on pricing, production, marketing, and materials purchasing within many of China's SOEs has increased substantially, some critical areas of decisionmaking, such as investment priorities and disposal of capital assets, remained largely at the government's discretion in the early 1990s. Efforts to rationalize production through mergers and acquisitions face constraints from government agencies which, as the owners of assets, often resist the acquisition of firms under their jurisdiction by firms outside their jurisdiction. And SOE managers remain constrained in labor decisions, leaving many enterprises saddled with excess workers and onerous wage and pension bills.

In other instances, parallel reforms necessary to make the State

sector more efficient have proved difficult to implement. Though early reforms called for allowing inefficient firms to go bankrupt, the implementing regulations to the 1986 Bankruptcy Law were slow to emerge. The government has to weigh carefully the costs of bankruptcy - loss of jobs and resultant political pressure - against efficiency gains. Local governments, unwilling to relinquish power and control over SOEs under their jurisdiction, tend to resist bankruptcy as well. Only about 10 percent of the 1,417 (mostly small) firms allowed to declare bankruptcy through the courts between 1988-93 were SOEs. The development of labor markets and social security schemes, both of which are needed to free SOEs from their labor obligations, will take some time to implement (see The CBR, January-February 1996, p.8).

Banking reforms also have been moving slowly, leaving banks with little incentive to ensure their lending is profit driven. In the early 1990s, about one third of SOEs were making "explicit losses" while another third had "hidden losses," where apparent profits are wiped out by crippling debts. Yet SOEs retain access to direct and indirect subsidies, including soft loans, cheap inputs, and non-collection of tax arrears. They face a growing "triangular debt" problem - they owe each other as well as the State-owned banking system - but by early 1995, no payments were being made on about one third of these debts.

Deepening reform

In November 1993, the CCP decided to accelerate SOE reform by restructuring State enterprises into modern shareholding companies. This reform was to be supported by increased moves toward full marketization. Experiments with shareholding corporations began on a limited scale in the mid-1980s and gained new momentum in the early 1990s. The official stock exchanges set up in Shanghai and Shenzhen in 1990 helped pave the way for greater shareholding experiments, along with the adoption of the new Company Law in 1993.

While hopes initially were high that the shareholding route would solve many SOE inefficiencies, once again, problems both old and new already have begun to surface. Wage pressures, for example, may divert earnings away from much-needed long-term investment. Government supervisory agencies continue to interfere with shareholding firms' management. And it is still too early for shareholders to gauge firm performance through the two stock markets, which have had their share of insider trading and stock manipulation. Moreover, most SOEs will be restructured, at least in the medium term, into limited liability companies rather than limited liability stock companies. Bank credit, therefore, rather than share issues, likely will be the dominant source of financing for most SOEs. However, the deeply troubled State banking sector is not yet capable of imposing financial discipline on SOEs.

A major problem that remains to be resolved is how to manage State assets efficiently. The leadership is committed to the dominance of the State sector in certain industries. The way to implement more efficient management of State assets, according to one popular view, is to establish intermediary institutions to represent the State Asset Management Commission (SAMC) by holding shares in SOEs. Such intermediaries could include State financial institutions, such as commercial banks, asset management firms, and investment firms. The objective of these financial institutions would be to maximize the value of State assets.

However, the notion of maximizing the value of State assets could result in new problems, as these State players might have a vested interest in the success of even non-performing SOEs. For example, if a financial institution invests in an SOE which turns out to be failing, the institution might push for the firm to merge with another SOE in which it holds shares, even though a private firm may be more efficient, and thus a more rational choice of merger partner. It might also prove difficult to close down a financially troubled SOE in which State financial institutions hold majority shares.

It is also far from clear that this scheme would avoid the same type

of bargaining process that occurred during the earlier reform efforts. Still to be determined is what type of incentive and monitoring system SAMC would adopt to hold these financial institutions accountable for their investment decisions. If, as is likely to be the case, these State financial institutions set up their local branches to hold shares in local SOEs or the local subsidiary of a parent SOE, strong local political influence likely will persist over decisions such as lending, merger, and asset transfer across firms. Another worry is that local financial institutions would monopolize local financial markets, thus diverting credit away from the non-SOE sector and leaving SOEs no closer to full accountability for their profits and losses. Yet another issue is that the institutional mechanisms are not in place to resolve potential conflicts among an SOE's managers, its workers, and the institutional shareholders. Conflicts could arise, for instance, when maximizing the value of State assets comes at the expense of closing the plant.

The context of reform

China's overall reform path is one of evolutionary change rather than revolutionary big-bang, in large part because it is difficult for a society to dissolve its collective past. The SOE sector is still in the process of reform, even as significant progress on other fronts continues to change the dynamics of the Chinese economy. The prospect of reforming SOEs cannot be viewed in isolation, though, but must be seen in the context of the growing non-SOE sector and increased market competition in China. The accumulated effects of China's sustained efforts to reform its economy have introduced, step by step, new institutional elements.

The continued expansion of the non-SOE sector likely will prove the most important stimulus for future SOE reform. The vibrant non-SOE sector has provided growth and employment, and has helped build demand for highly skilled workers and managers. It also has accelerated the learning process through which policymakers, the public, and growing numbers of enterprises recognize the payoffs from competition.

Other recent moves by the government suggest some firm footholds are being established in the reform effort. New tax reforms, for example, are moving China toward a modern taxation regime. A modern tax system has become a realistic goal, given China's increasing reliance on markets today.

China's external trade is integrating the country with the world economy - and making SOEs aware of the potential export opportunities for efficient producers. A more open trade regime creates more competition for SOEs. In addition, the abolition of the mandatory import/export plan leaves SOEs freer to pursue profits in a more competitive environment. Foreign investment, meanwhile, continues to pour into China at unprecedented levels, bringing new technology and new management expertise, as well as access to new markets.

Progress has also been made toward reforming social security and the wage and employment system crucial to minimize the political and social risks of SOE overhaul. The gradual establishment of medical, pension, unemployment, and other social welfare funds will relieve SOEs of the burden of providing basic social services. In many cities, the housing markets, too, are being commercialized, taking this burden off of SOE shoulders as well.

More difficult tasks that are essential for the success of SOE reforms are beginning to be tackled, including banking reforms, bankruptcy, and exchange of property rights. However, there is little chance of quick success; banking reforms, for example, though identified as a priority, will be particularly difficult to implement. Bank loans continue to be used to subsidize SOE losses. Some economists feel a huge recapitalization may be necessary, at the cost of perhaps as much as 15 percent of GDP. The success of banking reform, in turn, will be affected by the pace of SOE reforms in productive sectors, as loss-making SOEs will continue to demand soft loans.

Acquisitions and mergers are beginning to extend to medium-sized and

even large firms. One important step in the restructuring of SOEs through acquisitions and mergers will be the continued development of property rights exchange centers, of which about 180 existed nationwide in 1994. Set up to facilitate transfer of idle equipment across firms, the property rights exchange centers now cover a wider range of activities, including the auction of firms and management contracts. Further development of such centers needs to tackle the segmentation of markets, caused not only by lack of information and lack of professional capacity in accounting and finance, but also by the resistance of government institutions, including local governments, to the exchange of property rights across jurisdictions.

Over the next few years, the government's mission is clear, even if the course of future reform steps is not yet fully charted. A pilot project now under way in 18 cities, according to the State Economic and Trade Commission (SETC), will invest heavily in the technological renovation of some SOEs, but allow others to go bankrupt. In March, SETC Minister Wang Zhongyu reported that the project had resulted in 366 mergers and 103 bankruptcies by December 1995 - and the loss of 1.4 million SOE jobs. But both bankruptcy and mergers will face increasing social pressure resulting from massive layoffs and the resistance of government agencies unwilling to relinquish their jurisdictional power over their SOEs.

Under the Ninth Five-Year Plan, which commenced in January 1996, SOE reforms will focus on transforming the top 1,000 firms into "the pillars of the national economy." According to the plan, these 1,000 large and medium-sized SOEs account for 66 percent of total SOE earned profits and 51 percent of net SOE assets. Certain industries, including banking, communications, transportation, energy, and mining, will remain firmly under government control. Other industries, including light industry and textiles, will likely see a gradual withdrawal of State support. The 18-city experiment, meanwhile, will expand to 50 cities this year, with medium-sized and small SOEs encouraged to merge or reorganize as joint-stock corporations.

Further SOE reforms, thus, are likely to be gradual. It is of vital importance for the leadership to maintain the growth momentum of the non-SOE sector to sustain not only output and employment growth but also popular support for SOE reform. Policies and laws to encourage fair competition between SOEs and non-SOEs will be critical. Many within Chinese society have vested interests in the perpetuation of the SOE sector, making it more important than ever for the leadership to press the reforms forward at a steady pace.

Lili Liu is an economist at the World Bank. This article is based on a longer essay to appear in a forthcoming book from the University of Michigan's Center for Chinese Studies, Constructing China, edited by Kenneth Lieberthal, Shuen-fu Lin, and Ernest Young. The views expressed here are those of the author and do not reflect those of the World Bank or its affiliates.

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A gradual approach

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Abstract:

Over the past 18 years, China's leadership has taken a slow but gradual approach in its quest to transform state-owned enterprises (SOE) into modern, efficient companies. The reforms instituted to date have yet to complete the transformation of China's SOEs into fully marketized corporate entities, but have laid important groundwork for the long-term transformation of the SOE sector.

Text:

Headnote: Through trial and error, China's State enterprise reforms plot slow but steady progress
In 1978, China put reform of the Stateowned enterprise (SOE) sector at the core of its ambitious economic reform program. The objectives were clear: to eliminate State bureaucratic control of management, instill accountability for profits and losses, and improve efficiency. The means to achieve these goals were less clear, however. Over the past 18 years, China's leadership has taken a slow but gradual approach in its quest to transform State enterprises into modern, efficient companies. The various reforms instituted to date have yet to complete the transformation of China's SOEs into fully marketized corporate entities, but have laid important groundwork for the longterm transformation of the SOE sector.

The leadership's gradual approach recognized the difficulties the reforms would have to tackle. Decades of central planning left China with a huge and deeply troubled SOE sector. In 1978, SOEs (not including collectives) accounted for close to 80 percent of industrial output and 80 percent of urban and town employment. Since the various government agencies controlling an SOE could not possibly know every aspect of production, the planning process was driven by bargaining among State agencies and the SOE. This led to inefficiency and waste, duplication of investment projects, and stagnated technology. Managers and workers had little incentive to improve efficiency. Enterprises were eating from the same big pot (daguofan), regardless of how much they put in.

The first steps
The initial reform efforts that began in 1978 aimed at granting SOEs limited management autonomy and financial benefits. Sichuan Province was the first to experiment, followed by other trial efforts elsewhere. Under these experiments, firms would be allowed to **share** profits with the State after plan targets were met. The retained **profits** could be used, according to specified ratios, at the firm's **discretion** for **investment** and for bonuses to stimulate workers' efforts. SOEs under the experiment also enjoyed some freedom to make decisions about marketing and production, but were still responsible for meeting plan targets.

A number of problems and conflicts soon developed from these early

experiments. Conflicts arose between the small part of the system that was being reformed and the rest of the unreformed institutional structure. For example, SOEs participating in the trial reforms found it hard to market their products, as State monopolies remained in control of marketing channels. Enterprises could not trim operating costs by laying off redundant workers, as employment was controlled by local labor bureaus. Moreover, a firm's profitability might not relate to management efforts because of the existence of large price distortions. Plan targets and input allocations also hampered the manager's freedom to make production decisions. These constraints on managerial freedom created new opportunities for managers to bargain with the State. The decentralization of power turned into a struggle to gain maximum benefits. This, in turn, resulted in virtually no transparency, as formulas for profit retention varied across firms within the same industry, across industries, and across regions.

The next phase

In 1983, the SOE reforms were expanded to focus on taxation, pricing, and planning, with the goal of creating a more open and competitive environment for all SOEs. Li-Gai-Shui was launched to change the profit retention system to a system of taxing income and product. In 1984, "The Decisions by the CCP on Economic Reforms" called for moving China's economy away from a mandatory plan toward a guidance plan, so that the market would play a greater role in resource allocation. This was supported by policies to increase further the role of the non-SOE sector, such as collective and town and village enterprises (TVEs), and to expand foreign investment and SOE-private enterprise partnerships.

By instituting more uniform tax rates in lieu of profit sharing, Li-Gai-Shui attempted to minimize the bargaining that accompanied the profit retention system and help break down the control State agencies had over SOEs. Further, Li-GaiShui was intended to correct the impact of the distorted price structure. The new system also was motivated by the pressure of declining central revenues, largely a result of the profits retained by local governments and enterprises.
Li-Gai-Shui was implemented in two stages. The first step began in 1983, when income taxes were levied on SOEs, with after-tax profits divided into funds the enterprise could retain and funds to be remitted to the State. The second step, begun in late 1984, was aimed at the gradual introduction of a complete tax system. Of particular importance to SOEs were the product tax and the adjustment tax. Profit differentials across SOEs were partly due to the distorted price structure. For example, depending on their use of subsidized energy and raw materials, some SOEs stood to enjoy greater profits than other enterprises. A product tax was thus levied with differential rates on different industrial product groups. Products viewed as having higher profits due to distorted output/input prices were taxed more heavily than products viewed as having lower profits. An adjustment tax was further levied on about a quarter of SOEs with higher profitability, aimed at further reducing profit differentials caused by price distortions.

Using discretionary administrative intervention to put all SOEs on an equal footing proved inherently unworkable, however. In reality, the adjustment tax ended up being firm-specific, leaving negotiations to be settled on a case-by-case basis. Loss-making firms generally were able to avoid paying taxes, while profitmaking firms were taxed heavily. Though the deficiencies of the adjustment tax were recognized, the tax was regarded as a compromise step between reality and broader reforms.
Li-Gai-Shui was not an isolated experiment, but part of a wider movement toward increased reliance on market forces. Price adjustments and reforms, an integral part of the move to greater marketization, began in 1978 with

the State adjusting prices for goods in particularly short supply, including agricultural products, raw materials, and energy. By 1984, prices for producer goods outside the mandatory plan were allowed to float within a 20 percent margin. Recognizing that sudden price shocks across the market would prove disastrous, the government in 1985 adopted a dual-pricing system, which would prove to be one of the hallmarks of the Chinese reforms. Output within plan targets was to be sold at planned prices, but firms that fulfilled their plan targets were allowed to sell excess production at market prices. Plan targets were gradually reduced and the scope of market-determined prices was expanded. By 1993, market-determined prices accounted for 95 percent of total retail sales, 85 percent of capital goods and materials, and 90 percent of agricultural products. Only 5 percent of total industrial output was subject to mandatory planning.

Meanwhile, a series of proclamations issued since the mid-1980s further expanded the management autonomy of enterprises. These were codified into the Enterprise Law of 1988. In 1992, the State Council issued the implementing regulations to the Enterprise Law, which explicitly provided for noninterference by the government in the operations of State enterprises.

A new search

In the mid-1980s, SOE reform efforts ignited new and deeper debates on the issue of separating the State from the management of SOEs. By this time, the problems of the partial reforms were evident. Although by mid-1987 the central mandatory plan for industrial production covered only 20 percent of output, many lower levels of government continued to increase mandatory targets. Profit retention and Li-Gai-Shui turned into an exacerbated bargaining process and SOEs competed for financial benefits and concessions from the State. Moreover, investment, wage funds, and consumption expanded rapidly, pushing up price levels beginning in late 1984. The expansion was recognized by many in China to be a result of the weak financial discipline imposed on SOEs, as well as the poorly defined property rights of the State sector.

The search intensified for an appropriate management and incentive structure between the State and firm management so that the new autonomy of SOEs would be directed toward improving efficiency, rather than competing for financial benefits. The country experimented with various models, including the capital asset management responsibility system, shareholding, and the contract responsibility system (CRS). Of these experiments, the CRS expanded most rapidly and by 1988 had been adopted by the majority of SOEs.

The basic principle of the CRS was a contract between an SOE and the government for delivery of a lump-sum tax payment for a set time period. Once the contract was signed, the government was to separate itself from management decisions about production and the SOE's managers were to be held responsible for fulfilling the contract. Profits in excess of the tax payment became the discretionary earnings of the firm. Beijing hoped that the new system would stabilize central tax revenues through fixed-tenn contracts with firms.

But the implementation of the CRS, too, quickly encountered a number of problems. The process of reaching agreement on the contract resulted in heavy bargaining over the firm's tax base, subsequent tax increases, and other contract terms. Tax and finance bureaus, banks, and other institutions with a stake in the SOE all sought to bargain for their own position. For example, while the SOE would be interested in decreasing its tax base, the finance bureau would seek to maximize tax payments and reduce debt service, which was tax deductible; and the bank's primary concern was that its loans be repaid. As a result, contracts were not uniform, but depended on the actors and their clout.

The short-term nature of the contracts also proved problematic. With contracts usually running just one to five years, there was little incentive for SOEs to make long-term investments. The government had to compel SOEs to invest by obliging some firms to reinvest a certain percentage of their retained earnings. Contract monitoring and enforcement were weak, as contracts tended to be enforced primarily for profitable firms but only minimal penalties were levied on those that failed.

The long road

The accumulated effects of the first decade of reforms have substantially altered the environment in which SOEs operate, but the economic performance of the SOE sector has been less satisfactory than expected. Several studies conclude that SOE productivity growth is lower than that of TVEs or collectives, which do not enjoy the preferential treatment given to SOEs, such as government subsidies, soft loans, and guaranteed cheap materials (especially oil and electricity), and must survive on their own in the market or perish. Even more telling, industrialsector SOEs averaged 7.8 percent real annual output growth between 1980-92, compared to 18.4 percent for collectives, 64.9 percent for small private firms, and 37.2 percent for "others," a category which includes medium-sized and large private firms, joint ventures, and wholly foreign-owned firms. Over the reform period, the SOE contribution to industrial output decreased from around 80 percent in 1978 to less than 40 percent in 1994.

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In other instances, parallel reforms necessary to make the State sector more efficient have proved difficult to implement. Though early reforms called for allowing inefficient firms to go bankrupt, the implementing regulations to the 1986 Bankruptcy Law were slow to emerge. The government has to weigh carefully the costs of bankruptcy-loss of jobs and resultant political pressure-against efficiency gains. Local governments, unwilling to relinquish power and control over SOEs. under their jurisdiction, tend to resist bankruptcy as well. Only about 10 percent of the 1,417 (mostly small) firms allowed to declare bankruptcy through the courts between 1988-93 were SOEs.

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are needed to free SOEs from their labor obligations, will take some time to implement (see The CBR, January-February 1996, p.8).

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the local subsidiary of a parent SOE, strong local political influence likely will persist over decisions such as lending, merger, and asset transfer across firms. Another worry is that local financial institutions would monopolize local financial markets, thus diverting credit away from the non-SOE sector and leaving SOEs no closer to full accountability for their profits and losses. Yet another issue is that the institutional mechanisms are not in place to resolve potential conflicts among an SOE's managers, its workers, and the institutional shareholders. Conflicts could arise, for instance, when maximizing the value of State assets comes at the expense of closing the plant.

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(Table Omitted)

The continued expansion of the nonSOE sector likely will prove the most important stimulus for future SOE reform. The vibrant non-SOE sector has provided growth and employment, and has helped build demand for highly skilled workers and managers. It also has accelerated the learning process through which policymakers, the public, and growing numbers of enterprises recognize the payoffs from competition.

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Acquisitions and mergers are beginning to extend to medium-sized and even large firms. One important step in the restructuring of SOEs through acquisitions and mergers will be the continued development of property rights exchange centers, of which about 180 existed nationwide in 1994. Set up to facilitate transfer of idle equipment across firms, the property rights exchange centers now cover a wider range of activities, including the auction of firms and management contracts. Further development of such centers needs to tackle the segmentation of markets, caused not only by lack of information and lack of professional capacity in accounting and finance, but also by the resistance of government institutions, including local governments, to the exchange of property rights across jurisdictions.

Over the next few years, the government's mission is clear, even if the course of future reform steps is not yet fully charted. A pilot project now under way in 18 cities, according to the State Economic and Trade Commission (SETC), will invest heavily in the technological renovation of some SOEs, but allow others to go bankrupt. In March, SETC Minister Wang Zhongyu reported that the project had resulted in 366 mergers and 103 bankruptcies by December 1995-and the loss of 1.4 million SOE jobs. But both bankruptcy and mergers will face increasing social pressure resulting from massive layoffs and the resistance of government agencies unwilling to relinquish their jurisdictional power over their SOEs.

Under the Ninth Five-Year Plan, which commenced in January 1996, SOE reforms will focus on transforming the top 1,000 firms into "the pillars of the national economy." According to the plan, these 1,000 large and mediumsized SOEs account for 66 percent of total SOE earned profits and 51 percent of net SOE assets. Certain industries, including banking, communications, transportation, energy, and mining, will remain firmly under government control. Other industries, including light industry and textiles, will likely see a gradual withdrawal of State support. The 18-city experiment, meanwhile, will expand to 50 cities this year, with medium-sized and small SOEs encouraged to merge or reorganize as joint-stock corporations.
Further SOE reforms, thus, are likely to be gradual. It is of vital importance for the leadership to maintain the growth momentum of the non-SOE sector to sustain not only output and employment growth but also popular support for SOE reform. Policies and laws to encourage fair competition between SOEs and nonSOEs will be critical. Many within Chinese society have vested interests in the perpetuation of the SOE sector, making it more important than ever for the leadership to press the reforms forward at a steady pace.

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The paving of Wall Street in Eastern Europe: establishing the legal infrastructure for stock markets in the formerly centrally planned economies. (Special Section: Privatization)

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Abstract: The development of stock markets in Eastern European nations in essential to sustained economic growth and continued conversion to market-based economic policies. Capital improvements are best financed through equity because debt financing fosters dependence and can lead to increased financing merely to make debt payments. Privatization and stock market development are interdependent. More private firms increase the activities of equity markets, and increased interest in equity investments will advance privatization efforts.

Text:

I. INTRODUCTION

The Cold War has ended, and by all accounts, Eastern Europe has spurned the yoke of communist domination.(1) Idealists celebrate the advent of democracy in Eastern European nations such as Hungary, Poland, and Czechoslovakia, and newly independent, sovereign states have emerged from the once monolithic and omnipotent Soviet Union. While some people in these formerly planned economics enjoy by the fruits of capitalism, the road to economic and political reform has not been easy. Although state socialism may have been rejected, the Eastern European states have accepted capitalism only begrudgingly; difficult transition predominates in Eastern Europe and the former Soviet Union.(2)

A lack of capital has been one of the most formidable obstacles to a sustainable free market.(3) Industry and agriculture, both vita components of a functioning economy, rely on capital to generate output, replace broken parts, and modernize outdated, inefficient processes. Modernization is particularly essential as nations compete more with each other in an increasingly integrated global economy; a national economy in today's world must be able to effectively compete with other national economies or risk economic isolation. Accordingly, each nation must implement the latest technological innovations. This task is impossible without marking capital.

A variety of sources generate working capital: foreign and, borrowing, and equity markets are key sources. For developing nations, foreign aid has typically been a source of capital, taking the form of direct grants from industrial nations or international organizations.

Arguably a form of charity foreign and has its drawbacks. First, it is finite and generally fails to impact the recipient nation substantively. Second, fickle, prevailing politics influence the flow of funds. Third, recipients of foreign and frequently misallocate the funds. Foreign aid may be channeled to industries lacking the ability to effectively utilize such aid or to unscrupulous government officials who pocket the funds. Nevertheless, the major drawback of foreign and is that, far from enabling a nation to become economically self-sufficient, it tends to foster dependency.(4)

Borrowing also carries a number of negative implications. As demonsstrated by the problems of Latin American nations in the 1980s, debt obligations can burden a national economy and contribute to persistent government deficits.(5) Furthermore, banks and foreign governments are often hesitant to lend money to borrowers who have no demonstrable ability to repay the loans. This fact points to a conundrum: nations and businesses need funds to generate economic development, yet only economic development enables these nations to acquire such loans.

Equity markets, otherwise known as stock markets,(6) provide a source of capital for economic development without the drawbacks associated with foreign and and borrowing. Increased foreign debt obligations and concern for steady capital inflows have led many developing countries to focus their efforts on building viable stock markets.(7) Several nations have implemented measures to shift domestic business reliance away from loans and toward greater equity investment.(8)

Using stock markets as a source of capital for economic development makes sense in the current international financial environment. Although banks continue to play the major financing role in some nations,(9) there is a definite global trend away from reliance on the traditional bank lending system(10) toward a liquid securitized(11) financial system.(12)

For East European economies to integrate themselves into the free market environment, they must develop sustainable securities markets, particularly, stock markets. These markets can generate the funds necessary to fuel economic development and permit integration into the global economy. Until such change occurs, the specter of Communism, which lies dormant, ready to reassert itself if the transition to a free market system falters, will not be completely eradicated.

This Article will present and analyze the legal infrastructure necessary to the creation of viable stock markets in Eastern Europe. Part II will lay the framework for the paper by describling the economic and historical background of the region. Part III discusses the reasons for emphasizing equity over debt markets, focusing particularly on current privatization plans in the region. Part IV outlines major considerations in formulating the legal infrastructure for regional stock markets. Part V will summarize the future prospects for viable stock markets in Eastern Europe. All discussion will refer to primary rather than secondary markets, unless otherwise specified.(13) Similarly, discussion will focus on Hungary and, to a lesser extent, on Poland and the former republic of Czechoslovakia,(14) unless otherwise specified.

II. EASTERN EUROPE'S ECONOMIC ENVIRONMENT

A. Economic Background

Eastern European nations have grappled with their debt obligations in the 1990s,(15) although not as profoundly as many developing nations did in the 1980s.(16) For the most part, Hungary, Czechoslovakia, and Poland have managed their obligations better than their neighbors.(17) Responsible debt management in turn contributed to the global perception that those nations offered more hospitable investment environments than other Eastern European nations. This image has spurred larger private capital inflows into these countries than other former Soviet satellites.(18) However, compared to other developing nations, Eastern European nations have lagged far behind in attracting direct and portfolio equity investment capital,(19) reflecting a continuing reluctance of the industrialized nations to invest in the region.(20)

The unsatisfied need for an influx of foreign capital into Eastern Europe has resulted in a productivity gap with more advanced industrial countries.(21) Domestic sources of capital have proven insufficient for generating economic development in the region. Not only have the amounts been insufficient, but available capital has been inefficiently allocated.(22)

The nations of the region need substantial amounts of capital to bring East European incomes close to the average per capita income of the European Community. Recent statistics dramatically illustrate this gap. In 1990, European Community per capita income was approximately at $15,000 (1988 prices) and was expected to reach $20,000 by the year 2000.(23) In comparison, the average per capita income using 1988-1990 prices and exchange rates) of East European nations is substantially less: Czechoslovakia, $6000; Hungary, $5000; Poland, $3500; USSR (pre-dissolution), $2500.(24) To reach the European Community's 1990 income level by the year 2000, economists estimate that the former Soviet republics, Czechoslovakia, Hungary, and Poland would need respective GDP growth rates of 20%, 9.5%, 11.5% and 15.5% between 1991 and 2000.(25)

A corresponding amount of domestic savings or foreign investment, or a combination of both, is required to reach these growth rates. Based on 1989 actual domestic savings rates, Czechoslovakia, Hungary, and Poland lack sufficient domestic savings to finance the investment necessary to match EC growth rates in ten to fifteen years.(26) Consequently, these nations also need foreign investment to finance economic development. Stock markets can play a critical role in supplying capital to offset the shortfall of domestic savings throughout Eastern Europe and the former Soviet republics.(27)

B. Historical Background of Stock Markets in the Region

Most Eastern European nations, and a number of the former republics of the Soviet Union, have established or are establishing their own stock markets to attract foreign and domestic investment capital.(28) Domestic debt markets also have emerged in those nations as part of all embryonic securities market. Consistent with their pre-communist stock market traditions, Hungary, Czechoslovakia, and Poland have led the development of stock markets. Budapest and Prague first established stock exchanges in 1864 and 1871, respectively.(29) After World War I, stock markets were founded in other regional cities: Belgrade, Bratislava, Brno, Ljublijana, Warsaw, and Zagreb. All of these stock exchanges competed among themselves and with the major regional stock exchange in Vienna. Yet these stock exchanges were not stock exchanges in the modern sense, because bills of exchange and foreign currency transactions outpaced equity trading as the most common transactions.

Despite the existence of these regional stock exchanges, regional businesses were more likely to turn to banks in Vienna, Prague, and Budapest for financing. Scandals at the turn of the twentieth century, involving fraud and bribery undermined confidence in the stock exchanges as a source of finance.(30) The Prague Stock Exchange was an exception; strict control over trading by Czech authorities prevented similar malfeasance. Ultimately, World War II ended all stock market activity in the region.

Due to Communist influence following the war, securities activity remained dormant in Eastern Europe until the early 1980s, when Hungary began flirting with market economics by outlining rules for the issuance of bonds.(31) Within years, a respectable fixed-rate corporate bond market existed in Hungary. However, all Hungarian corporate bonds issued by businesses carried the Hungarian government's guarantee, unlike similar bond issues in the West. Further, all bonds contained the same fixed interest rate, which was substantially higher than domestic rates on long-term bank deposit.(32) Investors thus incurred no risk, rendering any market activity artificial.

After the global stock market crash in 1987, investor interest in the Hungarian bond market sagged as inflation rose.(33) The Government eliminated its guarantee program and introduced personal income taxes.

Investors scurried to rid themselves of their bonds in the face of rising inflation and rising deposit rates. As inflation crept higher, the Hungarian government began to tap the domestic market directly to finance its budget deficit, particularly by issuing treasury bills (T-bills). Until recently, T-bills were the only major type of security issued domestically.(34) As a major step toward creating a comprehensive securities market Hungary, forty-one members reestablished the Budapest Stock Exchange (BSE) on June 19, 1990.(35) The BSE was the first stock exchange to reopen in the region,(36) creating a market for Hungarian corporate equity. Despite minimal initial capital requirerements volume requirements,(37) and increased trading of foreign securities on international exchanges, trading in equities on the BSE remained stagnant during the first year and a half of operation.(38) Initially overalued stocks, insufficient share issuances, poor quality of investment options, high interest rates, the slow rate of privatization, and a general lack of investor interest attributed to this sluggishness.(39) In comparison, Hungarian bond markets experienced renewed activity, due in part to high interest rates.(40)

Securities markets have slowly begun to emerge slowly in other nations of the region. New stock exchanges have opened in Prague and Bratislava.(41) In Czechoslovakia, the bond market received a boost from substantial premiums over the month-to-month inflation rates offered on commercial bank bonds.(42) Other interest-bearing investment vehicles such as T-bills and commercial paper also compete for Czech investments.(43) However, the breakup of Czechoslovakia initially delayed the progress of privatization, anticipated to be the primary source of shares for trading on the new exchanges.(44)

In Poland, the Warsaw Stock Exchange reopened on July 2, 1991. As in Hungary and Czechoslovakia, early investor interest concentrated more on bonds than on stocks because of extraordinary, high interest rates.(46) Smaller stock exchanges have also opened in Zagreb(47) and Kiev,(48) where bond and T-bill trading similarly established footholds faster than equity trading. Despite the apparent profit potential for those who invest in bonds and other debt securities, these benefits can be deceptive when offered in an environment with a high inflation rate. Moreover, higher interest rates tend to denote riskier investment. Obligors have greater difficulty meeting high interest rates with their available capital. Therefore, equity 's a viable alternative not only to investors, but also to issuers.

III. The Elements of an Equity Market

A. Equity versus Debt(49)

Equity markets offer a number of advantages in generating capital when compared to debt or bond markets.(50) Like a consumer who uses credit cards too often, dependence on bond markets for financing can create long-term problems for the corporate or government borrower. As consumers charge more and more on a credit card, the outstanding balance grows larger, interest payments accrue, and the minimum monthly payment increases. Borrowers find they have increasing difficulty making their monthly payments, not to mention reducing the outstanding balance, unless their income increases proportionately Interest payments consume an ever greater proportion of their income, diverting resources from more productive uses like expanding or modernizing a business. Eventually, borrowers must borrow simply to service their interest payment obligations. Ultimately, due to the increasing debt load, creditors will deny these borrowers further access to credit. In such circumstances, borrowers are commonly forced to declare bankruptcy.

A similar dilemma confronts corporations and governments that rely on bond issuances. Their situation becomes more acute when the interest rates payable on bonds are exceedingly high, perhaps reflecting high inflation rates.(51) A number of East European bond issuances encountered high inflation rates.(52)

Businesses have extreme difficulty generating sufficient revenue to

pay both principal and interest while expanding and modernizing operations. The number of bankruptcies declared by U.S. companies that issued high-yield, junk bonds in the 1980s dramatically illustrates this point.(53) Despite respectable revenue levels, these U.S. firms were unable to service their debt obligations. Institutional underwriters denied them further access to the bond markets as issuers, effectively condemning them to bankruptcy court.

In light of the burdens associated with issuing bonds as debt instruments it follows that developing nations in Eastern Europe would focus their efforts on attracting equity investment capital by developing stock markets. Issuing shares in a company in exchange for investment capital does not require the extra financial burden of making interest payments. Such companies generally retain the **discretion** to pay dividends only when there is a **profit**. In return for the use of **investment** funds, the **shares** confer, by their number, a degree of control to the investor. Investors exercise that control through the power to vote on substantive, non-managerial matters relevant to the company's operations.(54) Debt financing will continue to provide an important source of capital finance in Eastern Europe, but a comprehensive capital market also requires strong stock markets.(55)

An equity market has two critical components: a supply of shares and a demand for shares. The monumental task of generating both components warrants a comprehensive strategy, particularly in developing nations. The decentralization of formerly planned Eastern European economies provides the unique opportunity to implement a strategy that can lead to fully functioning equity markets, given these nations' large domestic markets, vast supplies of natural resources, and skilled labor forces. Those equity markets, if successful, could generate investment capital to aid economic development and integration into the global economy.

B. Creating a Supply of Shares: The Role of Privatization

Privatization programs are the bedrock of stock market development in Eastern Europe. Essentially, privatization is the means by which the state divests itself of ownership in an enterprise or other forms of property.(56) The governments of Eastern Europe all envision selling shares in privatized companies to earn desperately needed investment capital. Viable stock markets will facilitate these sale transactions.(57) An efficient stock market can effectively value privatized companies and facilitate the transfer of companies into investors' hands.(58) On a macroeconomic scale, stock markets direct capital toward sectors of high return and increase efficiency by imposing financial discipline on companies.(59)

1. The Basic Legal Framework For Privatization

Privatization plans employ a variety of methods to distribute existing state holdings. Large state enterprises may be converted into joint-stock companies whose shares can be sold to both domestic and foreign private investors, including the company employees. Alternatively, large state enterprises may be broken up and sold or leased as smaller units. Another means involves reprivatizing or returning land, structures, and companies to the original owners prior to collectivization or nationalization. Since a complete discussion of the privatization process exceeds the scope of this Article, discussion will be limited to the role privatization plays in developing equity markets.

Privatization contains two basic legal components: the law and the plan. The law consists of the legislation that articulates the organizational and legal principles for the transformation of state ownership to private ownership. The plan sets forth the specific means by which those principles are to be implemented. Typically, most legislative bodies in Eastern Europe have no problem agreeing on general principles and enacting privatization laws. Formulation of the specifics, however, often generates rigorous debate.

Even before it converted from a communist to democratic state, Hungary began privatizing state assets.(60) The Company Act,(61) which took

effect in January 1989, was intended to ease the privatization of state-owned enterprises by laying out the various forms a privatized business enterprise may take. However, the act expressly excluded state enterprises from its provisions and thus failed to provide specific guidelines for the transfer of state-owned enterprises to the private sector.(62) It provided no legal rules to frame the transformation of a wholly state-owned enterprise into a private company.(63) This omission led to "wildcat" privatization, in which top management seized company assets and attempted to sell the assets to foreign investors, often at disproportionately low prices.(64)

The Transformation Act,(65) which came into force in July 1989, filled the void created by the Company Act by establishing a legal framework for the direct privatization of state-owned enterprises into companies.(66) The implementation of the Transformation Act and the establishment of the Hungarian State Property Agency (SPA)(67) in March 1990 were intended to nurture privatization. Nevertheless, the privatization of some 2000 Hungarian state-owned enterprises(68) proceeded at an excruciatingly slow rate.(69)

In response to the sluggish pace of early privatizations, the SPA announced the First Privatization Program in September 1990. The scheme scheduled the sale of shares for twenty of the largest profitable state-owned companies, totaling one percent of total state property. In order to solicit offers, the SPA in some cases floated shares on the Budapest and foreign stock exchanges beginning at the end of 1991.(70) However, because of delays, the First Privatization Program has been characterized as a failure. Many Hungarian government bureaucrats purposefully created logjams in the process, fearing that rapid privatization would bring widespread unemployment and a drop in gross domestic product.(71)

Despite problems with the First Privatization Program, the government announced a second round of SPA-initiated privatizations, the Second Privatization Program, in December 1990. The Second Privatization Program targeted nearly 100 state-owned enterprises for privatization.(72) This time, the government more closely regulated the privatization process to prevent abuses, such as insider dealings and the gross undervaluation of company asset,(73) that arose under the First Privatization Program.(74) The government viewed legitimization of the privatization process as imperative since it allocated much of the revenue earned from both SPA-initiated and non-SPA-initiated privatization(75) to reduce the national debt.

The task of privatization in Czechoslovakia (now the Czech Republic and Slovakia) has proven even more daunting. The extent of collectivization and nationalization was greater in Czechoslovakia than in any other Eastern European country, with the exception of the Soviet Union.(76) Prior to its "velvet divorce" in january 1993, Czechoslovakia enacted two basic laws establishing the framework for Czechoslovak privatizations One law pertained to the sale of smaller state-owned businesses.(77) The other law, which took effect April 1, 1991, introduced the use of investment coupons for the transformation of large businesses.(78) The government issued these investment coupons to all Czechoslovakian citizens over the age of eighteen, entitling the holders to purchase shares in certain Czech or Slovak enterprises.

Further, Czech and Slovak citizens can acquire ownership interests in state-owned enterprises through a scheme offering a choice between direct investments and investment funds loosely patterned after mutual funds. Since October 1, 1991, citizens have been entitled to buy books, each of which contains 1000 investment points for 1000 kroner approximately thirty-three dollars at the average 1991-92 exchange rate). The points are used to bid for those assets earmarked for privatization. Upon purchasing the books, each citizen must decide whether to invest the points directly in a company or entrust them to one of more than four hundred investment funds.(79)

Although frequently delayed, many forms of privatization plans have been implemented in almost every Eastern European country.(80) At the end of 1992, Russia finally began implementing a voucher-based privatization plan modeled after the Czechoslovakian plan.(81) Beginning in October 1992, all 150 million Russian citizens received voucher coupons entitling them to own shares in enterprises slated for privatization. Each voucher represents 10,000 rubles of state property and can be sold, held, or invested in enterprises. Under the most widely used method of privatization for large enterprises, fifty-one percent of all shares are or served for sale to the employees of the privatized firm,(82) while the remaining forty-nine percent are available for public dissemination.(83)

2. Privatization Issues Impacting Stock Market Development

a. Requiring Citizens to Pay for Shares

Privatization generally entails a two-step process. First, state enterprises arc converted into joint stock companies. Second, the shares are sold or otherwise distributed.(84) Several problems have arisen in this process, slowing down the rate of privatization in most Eastern European nations.(85) Although privatization laws are in place, their implemention has been an enormous task, reducing the speed with which stock markets have developed in the region.(86)

The fundamental point of contention concerns the criteria by which shares in state enterprises should be distributed.(87) Two approaches toward privatization of state-owned industries have evolved. The first favors the free distribution of shares to all citizens. Free distribution of shares comports with fundamental socialist philosophy, which holds that all state assets and properties are essentially owned by all citizens. Accordingly, citizens should not have to pay for something that they already own.

The second approach permits the sale of shares, both to citizens and to foreigners. Economists who advocate the first approach downplay the impact of capital generated by the sale of shares on the national economy and the development of any stock market. They assert that the amount of revenue raised would be small because the value of the capital stock in privatized companies operating in the formerly centrally planned economies is insignificant.(88) To illustrate their point, these economists theorize that even if a national privatization program could generate as much as fourteen percent of national GDP in investment capital, a privatization program implemented over a ten-year period (the current projected time necessary to complete privatizations) would not likely generate annual revenues much larger than one percent of GDP.(89) While this may be true, money is money and any funds that might be generated - no matter how insignificant - could benefit the region.(90) Furthermore, from an economic standpoint, if shares in state enterprises were issued without payment, private wealth would theoretically increase, thereby fueling private consumption and destabilizing the macroeconomic environment.(91)

While Public interest in state-owned assets may be undeniable, the free distribution of shares would undermine the long-term objectives of privatization, including the dissolution of monopolies, the establishment of financial markets, the institution of convertible currencies and a sound banking system, and the creation of conditions favorable to foreign investment. Comprehensive economic development will require all of these ingredients.(92) Although the free distribution of shares might achieve some of these objectives, the inflow of capital from the sale of shares is necessary to meet all.(93) Without new capital, there is no catalyst for economic development.

b. Foreign Ownership

Assuming a choice to sell shares rather than distributing them freely, a second issue arises in determining who will be allowed to purchase the shares. Shall foreigners be allowed to buy shares in domestic enterprises?(94) Nationalistic sentiment cautions against foreign domination and intrusions on sovereignty. Although no Eastern European nation has raised a strong clamor against the foreign acquisition of shares

with the possible exception of Poland),(95) the economic desirability of allowing foreign investors to purchase shares must be balanced with popular sentiment.

Limiting ownership to domestic investors is financially unsound, especially in places such as Czechoslovakia, where privatized assets totalling $100 billion greatly eclipse individual savings, which amount to only a few billion dollars.(96) Since domestic institutions cannot by themselves mobilize the necessary capital, foreign investment must satisfy any shortfall. Moreover, the non-capital foreign contributions that typically accompany capital investments, such as banking expertise, training, and technology, can also strengthen the region. Past experience in the Philippines and Indonesia, for example, has demonstrated that foreign equity led to the importation not only of capital, but skilled management as well.(97) These additional benefits have, in turn, tempered local consternation over foreign equity investment in those nations.

Many East European governments have attempted to assuage anxiety over foreign control by mandating government approval and quantitative limitations on the ownership of stock.(98) Although percentage ceilings may ensure domestic control of company management, quantitative limits generally are problematic. Ownership ceilings dissuade foreign investors from investing in jurisdictions hostile to foreign control. Furthermore, market activity after the primary offering renders foreign stakes difficult to monitor. Thus, it is unsurprising that Hungary, Poland, the Czech Republic, and Slovakia have largely removed percentage limits on foreign ownership.(99) Notwithstanding the explicit removal of quantitative limits, other conditions on foreign ownership in privatized companies remain somewhat ambiguous. Both privatization and foreign investment legislation often contain inconsistent provisions pertaining to foreign ownership.(100)

c. Mandatory Public Offerings

In addition to deciding whether to offer privatization shares to foreigners, the nascent market economies of Eastern Europe must also determine whether to force companies to go public, to sell shares in public offerings at stock exchanges. Opponents argue that conditions placed on publicly held companies, such as mandatory disclosure requirements and accounting standards, as well as the dilution of voting control, will constrain fledgling East European companies seeking to compete in the global economy. Those who promote public offerings counter that capital is needed for such competition and that the benefits achieved by, capital generation outweigh the bureaucratic costs of being a publicly held firm.

Korea offers a textbook illustration. The Korean government has ordered a number of companies operating in Korea to sell their shares publicly and has actively attempted to identify privately held companies that meet certain criteria as candidates for public offerings.(101) Companies that ignore government recommendations to sell their shares publicly face indirect sanctions including harsh tax treatment,(102) whereas companies that do offer their shares publicly receive tax breaks.(103) The Korean government encourages financial institutions to underwrite offerings by providing them with low interest loans. To alleviate concern over the dilution of domestic control, Korea has increased ceilings on non-voting shares.(104) As a result of these measures, Korea has one of the most robust, newly developed stock markets in the world.(105)

Nevertheless, some view such policies as unreasonably heavy-handed and damaging to a nation's image as a hospitable place to operate a company. Instead, they argue that governments should cajole companies by offering incentives and creating conditions to encourage public offerings. A government can provide tax incentives for public offerings as one obvious inducement. In drafting disclosure rules for publicly held companies, governments should account for secrecy interests in certain areas of operations to avoid overly intrusive disclosure obligations. Company decisionmakers must appreciate the advantages of using capital generated from public offerings to diversify and expand operations. Small private

companies also should be encouraged to merge with each other to effect a more efficient allocation of resources and provide the market with more attractive vehicles for investment capital. For example, Taiwan's liberal merger and takeover laws have generated larger companies that have, by virtue of their size, caught the attention of many foreign Investors.(106)

d. Asset Valuation

Share pricing and asset valuation raises perhaps one of the most frustrating problems related to the development of equity markets through Eastern European privatization. Although most economists maintain that shares should be offered at a price that fairly reflects the current market value of the underlying asset, shares offered in Eastern European privatized companies typically have been either grossly over-valued or undervalued.(107) However, the problem of misvaluation is understandable in light of the historically atrocious bookkeeping methods employed by companies in the former centrally planned economies. Former practices make net worth determinations nearly impossible because companies never had to account for fair market value or depreciation, particularly in accordance with Western standards. Similarly, liability valuations are uncertain because Communist systems often ignored or arbitrarily accounted for financial obligations to other parties.

The absence of efficient free markets similarly undermines the pricing process. Further., government officials responsible for setting initial share offering prices may fear either that initially underpriced shares would be interpreted as a sign of financial weakness that might scare away potential investors, or that overpriced shares will undercut profit potential, thereby dissuading future investments. Experience painfully demonstrates the need for professional auditing and underwriting services to assist in both ascertaining accurate valuations and determining pro formas of future net earnings.(108)

Market forces must be allowed to set fair prices without market distortions. Limits should be placed on initial subscriptions of shares to prevent price overshooting and stem speculation. The privatization and public offering of Ibusz, the Hungarian travel agency, illustrates the oversubscription problem. The Ibusz issue was twenty-three times oversubscribed.(109) Consequently, initial share prices increased drastically, generating inordinate profits for investors. Shortly thereafter, prices fell back just as dramatically as investors claimed their profits. The extraordinarily high share prices did not represent true market value, but rather an ability to exploit profits. Although this phenomenon also exists in Western markets, the effects of the price distortions are magnified in less developed equity markets. Thus, share valuation poses a dilemma: efficient markets ensure accurate share valuation, Vet accurate share valuations are necessary to efficient markets.(110)

Privatization programs must address the development of financial markets, because privatized companies offer the primary source of shares for such markets. In particular, public offerings of privatized companies offer the best means for facilitating broad-based ownership and liquidity. Regretfully, the slow pace of privatization and the embryonic size of the new stock exchanges constrain the number of new issues. For example, in Hungary, where the pace of privatization has been disappointing, shares of privatized companies constitute only twenty percent of trading on the Budapest Stock Exchange, which is by no means substantial.(111)

B. Creating a Supply of Shares: Attracting Foreign Issuers

Active trading in the stock market is necessary to guarantee efficient response to market forces. Since prudent investment strategy favors a diversified portfolio, numerous and varied choices of company stocks to buy or sell make active trading more likely to occur. Furthermore, trading volume heavily influences a market's liquidity and thus is important to its overall efficiency. Even if a substantial number of privatized companies offer and list their shares on Eastern European stock exchanges, those countries should solicit foreign companies to ensure

the availability of diverse investment options and draw more investors to trade on those exchanges.(112)

Even without government incentives, a foreign firm may perceive some benefits in offering and listing shares in overseas markets, particularly those in which it does substantial business.(113) A foreign listing may enable a company to make acquisitions or participate in a merger in that jurisdiction. Some countries only permit locally listed firms to make tender offers. A foreign listing may enable a company to avoid a decline in its stock prices resulting from a saturation of subscriptions in its home market. Offering shares on a foreign stock exchange generates foreign currency to finance foreign expansion, satisfy operating requirements, or meet long-term debt obligations in that jurisdiction. The foreign listing also facilitates direct access to institutional and individual investors, allowing companies to reduce transaction costs by eliminating duplicative and expensive registrations.(114)

A foreign listing also serves a marketing purpose. For exporters, a listing on the local exchange can introduce the company's products into Eastern Europe.(115) A local listing can score a public relations coup with local bureaucrats, who welcome any effort to contribute to domestic economic development. Company stock can be offered as compensation to boost employee motivation. Finally, companies dependent on trade secrets and confidential technical data can use a foreign listing as an alternative to a joint venture. The equity offering provides a means to meet and local ownership requirements without relinquishing control of technology,.

The governments of the Eastern European nations and the former Soviet republics should attempt to attract foreign listings on local exchanges through a variety of such policies. For instance, they should reduce the time and expense needed to comply with registration requirements. Reciprocal disclosure and financial reporting requirements could be adopted to make a prospectus satisfactory to regulatory authorities uniformly, throughout Eastern Europe,(116) thereby limiting legal and accounting costs by eliminating duplicative registration processes. Governments must balance the public need for regulation against the business need for liberalization and flexibility. Achievement of such a balance will render issuers more likely to offer investment vehicles in Eastern Europe.(117)

C. Creating Demand: Attracting Investors

A stock market cannot exist without the investors that provide the capital to initiate trading activity. The expectation of profit motivates investors to contribute money to a particular business. An assessment of the company's historical performance and its ability to perform in the future determines whether it will generate a profitable return to its investors. Despite a number of other issues that bear upon investment risk, perceptions of the stability and risks inherent to Eastern Europe will dominate investor decisions to participate in that market.

1 . Domestic Investors

A nation's citizenry provides its most accessible pool of potential investors. The various privatization schemes underway in Eastern Europe all envision broad investment participation by the indigenous population.(118) However, the task of instilling domestic confidence in stock markets presents a particular challenge in Eastern Europe and the former Soviet Union. In the former Soviet republics, for example, recent surveys indicate that most people do not have confidence in the concept of a free-market economy.(119) Although market economics has more than a two-to-one ratio of support in Eastern Europe,(120) past flirtations with stock markets fomented deep suspicions. In particular, the fraud and bribery scandals that plagued the region's stock exchanges prior to World War II(121) left a negative impression. Thus, stock market advocates in Eastern Europe must transcend prevailing skepticism to build confidence in the system and encourage local investment.

Some newly created stock markets have not made a substantive contribution to national economic development, owing largely to a lack of investor confidence.(122) Specifically, systemic deficiencies such as poor

information, insider trading, and market imperfections preventing the allocation of capital to the most efficient companies have undercut investor confidence.(123) Nevertheless, a soundly structured privatization process can overcome these obstacles and make equity investment attractive.

The success of a newly created stock market depends on the ability of its backers to mobilize domestic savings and stimulate domestic demand for equity investments.(124) Though high interest rates on deposits tend to immobilize savings in deposit accounts, high rates also discourage increased consumption and accumulation of physical assets. Thus, a balance must be struck in establishing macroeconomic policy that encourages sufficient savings for investment without diverting too much of capital resources away from domestic consumption.

Even though institutional investors provide the vast proportion of funds in a functioning stock market, newly created markets should solicit individual domestic investors. The involvement of citizens in stock markets makes political sense as well. Thus, opportunities that facilitate equity investment should be made available to the general public, and small stock quantities should be made available, rather than large minimum amounts that only large institutional investors or wealthy individuals can afford.(125) Other incentives might be afforded to citizens to purchase stock, such as tax preferences and accessible loans.(126) Companies also can stimulate equity participation by offering a large proportion of their equity base to individuals. Such schemes, however, must be well planned and should not deviate from sound business practices. Hungary, for instance, broke generally accepted rules and created a textbook example of conflict of interest when it allowed newly established commercial banks to advise their customers to buy shares they had just issued.(127) The banks compounded their indiscretion by providing loans to their shareholders without reference to the standard criteria for creditworthiness.(128)

Eastern European citizens must be educated to behave like experienced shareholders, a considerable feat in nations where most people have never been exposed to stock markets. They must be taught to evaluate financial information, such as prospect uses, so that they can participate in the market. Furthermore, the region's deep-rooted bias against long-term investment must be overcome. Nations that allow citizens to convert privatization vouchers into cash should offer tax incentives to buy equity, thereby detering people from taking the cash and depositing it in banks. Equity is difficult to sell, however, unless the dividend rate exceeds the rates on time deposits and savings accounts. Education may dispel the prejudice against long-term investments by teaching citizens to understand capital appreciation.

Various privatization plans implemented in Eastern Europe afford workers substantial equity holdings in privatized companies.(129) In specific instances, privatization plans have guaranteed workers a minimum percentage of equity ownership in their companies.(130) In contrast, the Czech government opted against entitling workers to obtain shares at a discount. Instead, unclaimed small enterprises are sold to the highest bidder.(131) The Polish privatization laws not only offer workers a fifty percent discount on the price of the issue, but reserve up to twenty percent of the shares of each enterprise for workers.(132) By ensuring employees have a vested interest in their companies by virtue of their ownership of shares, governments of the region can increase labor productivity while aiding the development of the stock markets.

2. Foreign Investors

Foreign investors constitute an important potential source of demand for shares in Eastern European companies. Because domestic savings alone will be insufficient to adequately capitalize the region's stock markets, foreign investment is necessary to fill the gap and ensure competitive stock markets.(133) Experiences in countries such as Korea demonstrate that foreign capital can contribute significantly toward attaining capitalization goals.(134) However, only foreign institutional investors, not foreign private individuals, will have the financial sophistication and

resources necessary to deal with risks posed by regional stock markets.

Foreign investors' participation in an overseas market is a function of their confidence in the overseas economy. Since political stability is an influential factor, regional governments may effectively generate foreign investment interest by shifting focus from their current shaky economic situations(135) to the potential economic gains that investment in the region could garner. In the last two years, foreign investors apparently have recognized this potential, particularly in those nations that have faithfully serviced their foreign debt obligations.(136)

IV. Establishing the Legal Infrastructure

An established legal infrastructure is fundamentally important to a stock market, from the perspectives both of issuers and investors. Laws must clearly specify issuers and investors' rights and obligations. The absence of a coherent body of written laws has been the major impediment to investment in Russia. New federal laws and decrees are passed nearly every day.(137) If published, they may appear in a wide variety of official and unofficial publications, most of which have not been translated from Russian to any other language.(138) However, no master list of new acts exists, which makes tracking the new laws virtually impossible. Furthermore, many of the new laws conflict with each other. No preemption rules have been created to resolve such conflicts.(139)

Even if coherent, well drafted laws exist, they must be implemented and enforced. Financial sustainability is not compatible with the arbitrary application of law. Moreover, an effective and proactive enforcement mechanism can legitimize the law. The following sections will outline the major issues connected with formulating the legislative framework for stock markets in Eastern Europe and the former Soviet Union.

A. Using Other Nations As Models

When formulating the legal framework for stock market regulation in Eastern Europe, it is important to remember that that countries of the region have individual characteristics and needs. Although this Article has generally focused discussion on the region as a whole, it is becoming increasingly difficult to make such broad generalizations.

A cursory review of Eastern Europe illustrates such disparities. Hungary possessing only ten percent of Eastern Europe's population, has until recently received the lion's share of the private capital funneled into the region, totaling more than $1.4 billion in 1991. This exceeds combined foreign investment in all the other countries of the region.(140) Poland has far greater debt obligations than any of its neighbors.(141) Czechoslovakia has divided into two separate sovereign nations. Yugoslavia, once showing an economy with great potential, has been ravaged by war. Romania is still grappling with its political transformation. In general, the northern tier of the region, Poland, the Czech Republic, and Hungary, has far brighter prospects than the southern tier, including Romania, Bulgaria, Slovakia, and Albania, where political and economic reforms have barely begun.

Nevertheless, the disparities among the Eastern European nations are insignificant when the region is compared with the United States, Western Europe, and other industrialized nations. In the United States and Western Europe, the Industrial Revolution contributed to the evolution of the stock markets. The need for capital during this period fueled stock market activity. In contrast, the Eastern European markets have emerged in response to political policy, rather than private economic demand. This reality makes it impractical to transplant the Western legal framework for stock markets in toto into Eastern Europe. The capital markets, levels of overall economic development rates of savings, and other economic and cultural influences differ too greatly.(142)

Further, years of central planning have created deep-rooted habits.(143) Accordingly, stock markets should be structured to account for the idiosyncracies and social attitudes of the particular market.

B. Disclosure Requirements: Securities Laws

Privatization, foreign investment, company, and securities laws form

the core legal infrastructure of stock markets in Eastern Europe.(144) Privatization laws aid the initial establishment of a stock market system by facilitating a supply of tradeable shares. Foreign investment laws set the rules by which both foreign investors and issuers participate in the domestic markets. Company laws lay the groundwork for privatization by establishing the legal organizational forms through which privatized enterprises must do business.(145) Finally, securities laws set forth the rules by which shares are issued and traded. Typical securities legislation includes disclosure requirements, capitalization requirements, and rules governing insider trading, anti-manipulation, takeovers, tender offers, and the licensing of broker-dealers.

The rules that govern company-shareholder communications comprise the bedrock of securities legislation. The laws in most jurisdictions recognize the right of potential investors to have access to certain information about the target company. Similarly, current shareholders, who require information necessary to evaluate value and growth prospects, commonly have access to basic information. The free flow of information is vital to a market-driven stock market.

If left to the discretion of corporate management, most companies would give out as little information as possible to their shareholders. First, the collection and dissemination of information tends to be labor-intensive and expensive, particularly in developing nations that lack sophisticated and reliable postal and communications systems. Second, management naturally refrains from disclosing information adverse to its position, including reports on financially unprofitable operations and executive compensation amounts. Consequently, only regulation can guarantee disclosure of necessary investment information to prospective and current shareholders.

Nevertheless, disclosure requirements should not impose such burdensome collection and dissemination costs that they effectively preclude companies from offering stock in a particular market. A delicate balance must be achieved so that shareholders receive complete and reliable information. International custom specifies standard information to be disclosed to investors. The individual nations should incorporate these items into their respective securities laws, both to ensure informed investments and to enable the region's future integration into the global securities market. Thus, they should provide access to balance sheets, statements of financial operations (profit and expense reports), management discussion and analysis of operations, pro forma financial statements, identification of members of the board of directors and key management personnel, discussion of known or potential risks to a company's operations, and a description of business.(146)

Other items, such as executive compensation, lack a complete international disclosure consensus.(147) Obviously, a company that takes great pains to maintain secrecy will not subject itself to strict disclosure requirements and will consequently refrain from engaging in a public offering. Nonetheless, the developing stock markets of Eastern Europe have implemented prospectus requirements with varying disclosure standards.(148)

While it may be impossible to transplant Western standards directly to the nations of Eastern Europe, disclosure standards should be harmonized to the greatest extent practicable. Common accounting standards, in particular, are crucial to a successfully operating market. The methods employed to calculate net profits, assets and liabilities should conform to Western auditing and accounting procedures, the generally accepted accounting principles (GAAP) of the United States,(149) commonly utilized by foreign issuers and investors. Any cost of reconciling regional auditing and accounting standards with Western procedures will diminish foreign participation in the stock markets. To the extent the credibility of Eastern European financial statements would be undermined, the disparity could discourage both foreign and domestic investment alike.

Regional stock markets also must ensure the reliability of disclosed

information. The timeliness of disclosure is particularly relevant. Investors, particularly Western institutional investors accustomed to instantaneous dissemination of information, should have access to the most recent financial information, because even a one-month delay can preclude a well-informed investment decision. Unfortunately, Eastern European nations do not yet have sufficient technology to disseminate current information in a timely manner.

Educating domestic investors to understand disclosed information raises another dilemma. Disclosure has value only if the information affects investment decisions. The most obvious means to achieve a financially sophisticated public is to provide more business classes, not only as a part of normal schooling, but also as continuing education to those who have completed their schooling. Credit agencies such as Moody's and Standard and Poor's should be established and promoted to assist the evaluation of investment opportunities. These credit agencies would have the professional ability to assess and rate a company offering its shares to the public.

C. Clearance and Settlement

Clearance and settlement logistics presents one of the most important, albeit excruciatingly boring, areas that regulation must address to ensure an efficient stock market. Clearance and settlement refers to the process of confirming and paying stock transactions. The process involves determining what the counterparts owe, what they are due to receive, and on what date they will receive it. Absent an efficient clearing and settlement system, parties to a stock transaction incur the risk of either not receiving payment or not receiving the stock purchased. These risks increase as the volume of trade grows.(150) Prudent drafting of the legal infrastructure for stock markets in the formerly centrally planned economies should therefore lay out a comprehensive clearance and settlement mechanism to ameliorate such risks. To date, however, no substantive written rules exist.

International studies indicate that risks attributable to clearance and settlement can be contained by shortening the time between the trade date and payment date, promoting trade guarantees, and assuring the simultaneous exchange of payment and securities.(151) These goals require technologically advanced automated system. In major markets, market participants formulate the rules for clearance and settlement, such as the number of days in which a trade should be settled.(152) In turn, the number of days by which this time period can be shortened invariably depends upon the degree of automation available. Unfortunately, automation is expensive. Nevertheless, the costs in implementing an efficient system will be recouped if the automation attracts investors and issuers to participate in the stock markets. As a major facet of its clearance and settlement system, each nation should establish an effective central securities depository employing a book entry system. In this way, trades may be facilitated by using simple debits and credits on the books of the central securities depository.

The ownership and management structure of a central securities depository ultimately is determined by its legal structure and the regulatory environment. A depository may take the form of a government agency, a private company, or a subsidiary of a company or entity. The identity of the governmental agency that will regulate the central securities depository depends upon who owns the depository. For example, if the depository is a subsidiary of a banking and fiduciary entity, the government agency that regulates banks naturally would oversee its operations. Ideally, the regulatory system should enable all segments of the securities industry, both governmental and non-governmental, to own or at least participate in the central securities depository in order to have the protection of a checks and balances system.(153)

While clearance and settlement systems remain in embryonic and disorganized forms throughout most of Eastern Europe and the former Soviet republics,(154) Hungary offers a prototype to which its

neighbors should aspire. The Budapest Stock Exchange began operating a central depository in 1992 and clears all transactions by means of the central bank, the National Bank of Hungary.(155) Every transaction is settled on the fifth day after the transaction, and a clearing fund is used to minimize the risks of losses attributable to failure to match trades. The BSE is studying further development of its settlement system including increased computerization, modernization of the legal framework, dematerialization of securities,(157) and improved cross-border settlements.(58)

D. Enforcement

The credibility and efficacy of any regulating regime depends upon whether laws arc adequately enforced. Without an appropriate enforcement mechanism to detect and deal with violations of the rules laid out by stock market regulations, investors and issuers will not participate in the system. Arbitrary or half-hearted enforcement of laws will cause regional stock markets to fail, which in turn will substantially undermine efforts to stimulate Eastern European economies.

The creation of a special governmental body vested with powers to enforce stock market laws is the best means for ensuring compliance. In most industrialized nations with active stock markets, quasi-independent governmental agencies serve as effective monitors. The U.S. Securities and Exchange Commission, for example, has diligently administered and enforced the securities laws of the United States, thereby contributing to the most active securities market in the world.(159)

The tendency of regulatory agencies to act both as regulators and promoters of the national stock market is a major problem in developing nations.(160) Such a blatant conflict saps confidence from the system. Nevertheless, a developing nation must make concerted efforts to promote its stock market. The Korean stock market should be a model to the Eastern European nations and former Soviet republics. Korea has separated regulatory and promotional functions, delegating their functions between two agencies. The Korean Securities and Exchange Commission oversees stock issuances and fair trading, while the Korean Supervisory Board deals solely with promoting new offerings.(161)

Given its progressiveness in other areas of stock market development, it is not surprising that Hungary has dealt with regulatory oversight in much the same way as more sophisticated, industrialized nations. Hungarian securities legislation created the State Securities Supervision and delegated regulatory oversight responsibilities to it, including ensuring the adequacy of prospectus disclosure, issuing permits for public offerings, licensing stock traders, and supervising overall market activity on a continuous basis.(162) The Budapest Stock Exchange, like other international stock exchanges, is a self-regulating organization over which the State Supervisory Board exerts lesser influence.(163)

In contrast, the Ministry of Finance, through an appointed commissioner rather than a specially formed entity, oversees Czechoslovakia's stock market activities.(164) Russia has no oversight commission; however, President Yeltsin has recently appointed an official to establish a commission to police the nearly one hundred stock exchanges operating in Russia.(165)

E. Capital Flight

Capital flight poses a major problem to nascent Eastern European stock markets. Flight occurs when foreign or domestic investors export any profits they receive from the stock market out of the nation instead of reinvesting those dividends back into the stock market or some other domestic investment vehicle.(166) The decision to repatriate profits and sometimes even original investment capital may be in response to a number of factors. These factors may include domestic financial or political crises, high taxes, prospective tightening of capital controls, domestic currency devaluation or volatility,(167) actual or incipient hyper-inflation, foreign speculation opportunities,(168) or a combination of these factors.(169) Capital flight is considered a prime factor

contributing to the foreign debt problems of developing nations.(170)

If unchecked, capital flight can damage a country's economy. The outflow of money from a nation depletes foreign exchange reserves, which in turn depreciates the domestic currency's exchange rate and destabilizes interest rates.(171) This situation creates inflationary pressures and undermines the government's ability to maintain monetary control, particularly in countries with less developed financial systems.(172) Capital flight also undermines public confidence in the currency, contributing to speculative capital movements. Furthermore, capital flight disrupts a country's balance of payments by contributing to a current account deficit, thereby making it more vulnerable to external economic forces.(173)

Capital flight more acutely affects developing nations by contributing to the erosion of the domestic tax base. Developing nations are particularly vulnerable because they lack developed financial markets in which they can issue government securities (such as treasury bills) to finance fiscal deficits, thereby making them more dependent than industrialized developed nations on tax revenue.(174) Capital flight essentially depletes a nation's capital resources, leaving less money to invest in the domestic economy.(175) Developing nations routinely impose capital controls to curb problems created by capital flight. In the 1970s and 1980s, countries Argentina and Korea vigorously enforced restrictions on capital exports and actually succeeded in controlling capital flight.(176) Typical means by which developing nations control capital flight include restrictions on foreign currency exchange transactions, requirement of government approval for any domestic capital exports, and outright prohibitions of all exports of profits.(177) Less direct methods include the imposition of fees or taxes large enough to make any transborder remittance prohibitive.(178)

Under some circumstances, the international community condones capital flight controls. The International Monetary Fund, for example, has recognized the need of some developing nations to impose controls on capital outflows for the purpose of correcting balance of payments deficits.(179) Despite occasional international approval of the use of capital controls, the capital flight dilemma places developing nations, including those in Eastern Europe, in an unenviable position. They must attempt to strike a balance between stemming capital flight and encouraging investment. Restricting investors' ability to repatriate their profits understandably dissuades foreigners from investing in a national market. Moreover, a country that implements capital controls saddles itself with monitoring expenses and exposes itself to possible retaliation from other countries. Furthermore, capital controls distort domestic currency exchange rates.(180)

Liberalized capital movement policies can actually ameliorate capital flight and serve to attract foreign investment capital. In this vein, international organizations, most notably the World Bank, have issued model guidelines as to how nations should address capital movements.(181) These guidelines call upon nations to allow the full repatriation of original investment capital and profits.(182) Although actions such as amnesties(183) and the issuance of foreign currency denominated or securities in abating capital flight, unrestricted instruments (184) or securities (185) aids in abating capital flight, unrestricted capital movement best serves sustained stock development. Secure in their ability to repatriate profits at will, foreign investors will more readily participate in an overseas economy with liberalized capital movement policies. Similarly, reassured that they can transplant their assets as economic circumstances warrant, citizens will have more likely invest in domestic, rather than foreign, stock markets.

Recognizing the benefits afforded by maintaining liberal capital movement policies, Eastern European nations generally allow unrestricted capital exports. In Hungary, Poland, and Czechoslovakia, foreigners may repatriate their profits and liquidated investments.(186) Recent U.S.

bilateral treaties with these nations reaffirm and, in some cases, expand the right of repatriation.(187) Similarly important are assurances that, in the event a government believes it must expropriate an investment, it will make prompt and adequate compensation in an amount equal to the market value of the investment at the time of expropriation.(188)

V. Conclusion

Whether Eastern European stock markets will be successful in generating the capital resources necessary to enable the region to compete within the global economy hinges ultimately upon the underlying economic and political stability of each nation. The current fluid economic and political climate makes it impossible to predict the role that stock markets will play.

From an economic standpoint, the privatization process is crucial to the development of stock markets in each nation. The slow pace of privatization in most nations has undermined stock market growth insofar as each stock market is dependent upon privatized companies as a source of shares.(189) Without shares, there can be no investors. Further, investors will not participate in economies teetering due to uncontrolled inflation and difficulty in meeting external debt obligations. The future is difficult to predict. Just last year, Poland was struggling to make its foreign debt payments while Hungary was viewed as a role model among debtor nations for faithfully making its debt payments. Now Poland has stabilized its debt burden, while Hungary's per-capita foreign debt has become the highest in Eastern Europe, creating increasing concern among its creditors.(190)

Equally uncertain is the political stability of the region. Eastern Europe has a tradition of volatile politics, which has been reinforced by the recent collapse of the Polish government in May 1993.(191) The drive by most of the Eastern European nations to become full fledged members of the European Union (the Union)(192) has tinged relationships with nations outside the Union, making potential investors from those nations apprehensive.(193)

Investment experts have suggested a number of creative ideas to bolster investment in Eastern European stock markets and enable them to more effectively compete with other stock markets. Linking the regional stock exchanges has the potential to create a single, more diversified, and consequently more attractive market.(194) However, efforts to link the exchanges would require substantial cooperation and coordination of economic policies among the nations, an unlikely if not impossible feat. Selling shares through investment funds that specialize in Eastern European stocks presents a more cogent means to market regional stocks internationally and domestically. A number of large investment companies offer the opportunity to invest in funds holding shares in a variety of Eastern European companies, thereby providing diversification and reduced risk.(195)

The development of stock markets in Eastern Europe involves endless variables, and the task of establishing the legal infrastructure for a sustainable and viable market is daunting. The nations of the region must confront complex issues. Yet with persistence, fortitude, Western experience, and simple trial and error, the stock exchanges in Budapest, Warsaw, Prague, Bratislava, and other cities in the formerly centrally planned economies can some day rival their Western counterparts and generate the capital necessary to fully integrate Eastern Europe into the global economy. (*) LL.M. candidate, University of Washington School of Law; former attorney, U.S. Securities and Exchange Commission, Washington, D.C.; J. D., University of georgia; B. A., University of Virginia. (1.) See, e.g., Bernard Gwertzman & Michael T. Kaufman, The Decline and Fall of the Soviet Empire xvii (1992) (describing the splintering of the Soviet bloc); The Breakup of Communism: the Soveit Union and Eastern Europe (Matthew A. Kraljic ed., 1993) (discussing the disintegration of the Soviet Union due in part to the rejection of communist ideology). (2.) See generally David M. Kemme, Transitions in Europe and the Soviet Union:

Issues and Strategies (1991) (arguing that the postcommunist transitition period of the former Soviet empire will be lengthy and arduous, outlasting Germany and Japan's democratic reconstruction period). (3.) Specifically, some economists assert that the allocation, maintenance, and formation of capital represents the paramount issue in changing from a centrally planned to a market economy. See, e.g., Jozef M. van Brabant, Property Rights Reform, Macroeconomic Performance and Welfare, in Transformation of Planned Economies: Property Rights, Reform,and Macroeconomic Stability 30 (Hans Bloomestein & Michel Marrese eds., 1991) [hereinafter Transformation of Planned Economies]. (4.) For an analysis of the negative consequences emanating from foreign aid, see Kevin Dahaner et al., Help or Hindrance?: United States Economic Aid In Central America 1-4 (1987); Roger C. Riddell, Foreign Aid Reconsidered: Johns Hopkins Studies in Development 85-127 (1987). (5.) Fortunately, however, the debt burden has been eased in recent years among the fifteen most heavily indebted developing countries. In 1990, claims on these nations fell by $28 billion, due in part to debt conversion and restructing programs such as the program in Yugoslavia. See International Monetary Fund, Private Market Financing for Developing Countries 4 (1991) [hereinafter Private Market Financing]. (6.) Equity refers to a stockholder's proportionate share, or ownership interest in a corporation whereas equity financing entails the raising of capital by a corporation by issuing, or selling, stock. Black's Law Dictionary 540-41 (6th ed. 1990). This activity contrasts with debt financing, raising capital by issuing bonds or borrowing money. Id.; see also infra at subpart III(A). (7.) See Robert B. Dickie & Thomas A. Layman, Foreign Investment and Government Policy in the Third World 167 (1988). (8.) For example, Korea issued guidelines in 1986 that severely curtailed the range of corporate activities eligible for foreign currency loans from offshore sources partly for currency exchange control reasons, but also to stimulate its equity markets. See Kye Sung Chung, The Internationalization of the Korean Securities Markets: Legal and Economic Perspectives, 27 Colum. J. Transnat'l L. 27, 38 (1988). (9.) See Marvin R. Jackson, Company Management and Capital Market Development in Transition, in Creating Capital Markets in Eastern Europe 71 (John R. Lampe ed., 1992). Germany, where banks actively involve themselves in company management, investment banking, and brokerage services, represents the most conspicuous example. Id. (10.) But see Lawrence J. Brainard, Strategies for Economic Transformation in Central and Eastern Europe: Role of Financial Market Reform, in Transformation of Planned Economies, supra note 3, at 95-96 (taking the position that the banking system will be the most important institutional element of the capital market in the near future). (11.) The term security generally incudes any note, stock, treasury stock, bond, debenture, evidence of indebtedness, or certificate of interest or participation in any profit-sharing agreement, collateral-trust certificate, preorganization certificate of subscription, transferable share, investment contract, undivided interest in oil, gas or other mineral rights, or any put, call, straddle, or index of securities. 15 U.S.C. $S 77 (b)(1) (1988). (12.) See generally International Monetary Fund, International Capital Markets: Developments, Prospects and Policy Issues (1992) [hereinafter International Capital Markets] (discussing shift from baking systems to securitized money and capital markets). More creditworthy corporate borrowers in major industrial countries are increasingly able to meet their liquidity, risk management, and financing needs directly in liquid securities markets. Commercial paper and repurchase agreements have become the most popular short-term financing instruments. Id. at 2. Money market mutual funds are siphoning deposits out of the banking system, thereby displacing the role of banks. Id. In 1985, international bank lending decreased to $21.6 billion while international bond and note issues (non-equity) stood at $162.8 billion. Bank for International Settlements, Recent Innovations in International Banking 130 (1986). (13.) A primary market hosts initial sale of new securities by their issuer, in contrast with a secondary market, which only trades previously issued securities. See Black's Law Dictionary

1191 (6th ed. 1990). (14.) Czechoslovakia officially divided into two separate sovereign nations, the Czech Republic and Slovakia, on January 1, 1993. For the purposes of this paper, "Czechoslovakia" shall collectively refer to the two nations, each of which has predominantly retained the federal legislation enacted prior to separation. Most legislation previously in force has been, or is in the process of being, adopted into national laws by transformation acts. See World Accounting Report, Mar. 1993, available in LEXIS, Nexis Library,NEWS File. (15.) Total debts owed by the Central and Eastern European countries equaled $195 billion at the end of 1992, $13 billion higher than outstanding debt at the end of 1991, See Growing Exports and Reductions Improve Polish Debt. PAP, Mar. 11, 1993, available in LEXIS, Nexis Library, WIRES File. Poland struggled to service its $45 billion foreign debt in 1992, but appears to have regained control in 1993. Id. Hungary had a gross foreign debt at the end of July 1992 of $22.8 billion. L. Perrin, Hungary: Recovering Economies, Through the Pain Barrier,Euromoney, Jan. 19, 1993, at 89. In 1993 Hungary's foreign debt became the highest per capita in Central and Eastern Europe, causing some creditors o worry about its future ability to meet its obligations. See Competition for Capital Likely to Intensify, Euromoney, Mar. 16, 1993, at supp. Hungary's estimated budget for 1994 anticipates a record deficit of $3.3 billion, which will constitute approximately 8.4% of its gross domestic product. See Kardy Okolicsanyi, Hungary's Budget Deficit Worsens, RFE/RL Res. Rep., Jan. 14, 1994, at 36. Czechoslovakia had a gross foreign debt in September 1991 of $9.3 billion. See The Guide to World Equity Markets 611 (Stuart Allen & Selina O'Connor eds., 1992). (16.) Although often referred to as "developing" nations themselves, the countries of Eastern Europe and the former Soviet republics are now called "Economies in Transition" (EIT) as they are in the process of making the transition from a centrally planned system to a free market economy. See Vinod Rege, Economies in Transition and Developing Countries, J. World Trade 83 (Feb. 1993). Despite their special classification, EIT's are increasingly treated on the same footing as developing nations by the international financial community, based strictly on economic criteria. Id. at 85. (17.) Hungary, the Czech Republic, Slovakia, and Poland were "the only countries in the region which have managed to stabilize or cut their debts at the end of 1992." Growing Exports and Reductions Improve Polish Debt, supra note 15. Poland has had problems servicing its foreign debt; in September 1991, the economic situation looked bleak when Poland's ability to pay off its foreign debt of $30 billion was in doubt. See Poland, Don't Panic Economist, Sept. 7, 1991, at 52, 52. Because of recent disastrous economic policies, Slovakia nearly cannot service its 1993 foreign debt. See Czechs and Slovaks, Not So Amicable, Economist, Apr. 17, 1993, at 50, 50. (18.) Available statistics of private foreign capital inflows report figures only for Czechoslovakia, Hungary, and Poland. By the end of the third quarter 1992, an estimated cumulative direct foreign investment of $7 billion had poured into Eastern Europe, of which $4.2 billion was targeted for Hungary. See Perrin, supra note 15, at 89. However, recent trends indicate an increasing hesitancy on the part of foreigners to invest in Hungary because of the slow development of equity markets, itself a product of the slow pace of privatization. See Foreign Investors Cautious on Hungary, Int'l Herald Trib., Jan. 16, 1993, available in LEXIS, Nexis Library, NEWS File. The vast proportion of that direct investment is attributed to Hungarian and Czech bond issuances. A large portion of those bonds were placed with commercial banks, in exchange for relief from syndicated loans that were not being refinanced. See Alice Teichova, Interwar Capital Markets in Central and Southeastern Europe, in Creating Capital Markets in Eastern Europe, supra note 9, at 35. (19.) 1991 Estimates of Direct of Portfolio Equity Investment (in millions of US$):

Czechoslovakia, Hungary, and Poland	1,400
Latin America	20,400
Malaysia	3,800

Thailand	2,200
Indonesia	1,400
Portugal	3,500
Turkey	3,400

Id. at 35. Direct investment entails investment of capital in physical assets or in ownership of a whole enterprise, while portfolio investment involves the purchase of securities. Webster's Third New International Dictionary 640, 1768 (1981). As of April 1993, emerging markets accounted for more than 5% of worldwide capitalization, up from less than 2% 20 years earlier. See R. C. Longworth, Emerging Stock Markets Bustling, Chicago Trib., Apr. 18, 1993, at C1. (20.) See generally Jane Perlez, Eastern Europe's Promise Fades, N.Y. Times, Feb. 21, 1993, [sections] 3, at 17 (asserting that inflation rates, political problems in former Yugoslavia, and unstable privatization policies are responsible for the reluctance to invest). (21.) The productivity gap between centrally planned economies and advanced industrial nations may also be attributed to inaccurate pricing, the lack of incentive for managers and workers to improve efficiency, and the distorted allocation of capital and manpower. See Daniel Gros & Alred Steinherr, Economic Reform in the Soviet Union: Pas De Deux Between Disintigration and Macroeconomic Destabilization 47 (Princeton Studies in Int'l Finance, No. 71, Nov. 1991).

Productivity Gaps Between Eastern and Selected Western Countries in 1989

Eastern European Countries (and USSR)	Western Reference Countries	Productivity of East as % of West
Bulgaria	Greece, Portugal, Spain	27%
Czechoslovakia	Austria, Greece, Portugal, Spain	28%
Hungary	Greece, Portugal, Spain	26%
Poland	Greece, Portugal, Spain	21%
Romania	Greece, Portugal	40%
USSR	Greece, Portugal	30%

Alessandro Giustiniani et al., Growth and Catch-up in Central and Eastern Europe: Macroeconomic Effects on Western Countries 10 (International Finance Section, Dept. of Economics, Princeton Univ., No. 186, April 1992). (22.) Gross & Steinherr, supra note 21, at 47; see generally Larence J. Brainard, Strategies for Economic Transformation in Central and Eastern Europe: Role of Financial Market Reform, in Transformation of Planned Economies, supra note 3, at 95-96 (discussing the role of the banking system in the course of privatization in order to lead to efficient capital allocation). (23.) Gros & Steinherr, supra note 21, at 48. (24.) Id. (25.) Id. at 48-49. (26.) Using a conservative savings rate of 20%, economists suggest that Czechoslovakia could finance the investment necessary to reach European Community levels in ten years, Hungary would require twelve years, and Poland would require fifteen years. The Soviet Union would require much more time, or foreign investment of more than $1300 billion accumulated over fifteen years. If. at 50. These estimates, however, were derived in 1991 before the realization that income levels would not support projected savings levels due in great part to the slow rate of economic development and high inflation. See Transformation of Planned Economies, supra note 3, at 51-64 (discussing problems associated with privatization of socialist economies, including capital formation). (27.) Other developing nations have also attempted, with mixed results, to

develop stock markets, including Brazil, South Korea, Malaysia, Mexico, Nigeria, Pakistan, Philippines,Singapore, Taiwan, and Thailand. See Dickie, supra note 7, at 167. (28.) See generally Scott Powell, Slow Steam Ahead in Debt and Equity, Euromoney, Apr. 1992, supp. at 11-15 (detailing recent advances in Eastern Europe's domestic capital markets). (29.) Creating Capital Markets in Eastern Europe, supra note 9, at 8. The first stock exchange in Central Europe was established in Vienna by a decree of Empress Maria Theresa. The first stock exchange in Europe was established 300 years earlier in Antwerp, followed 100 years later by the Royal Exchange in London. The exchanges in Prague and Budapest preceded the establishment of Berlin's stock exchange. Id. (30.) Id. (31.) See Powell, supra note 28, at 11-15. (32.) Id. at 11. (33.) By 1990 inflation had reached an annual rate of 30%. Creating Capital Markets in Eastern Europe, supra note 9, at 49. (34.) Powell, supra note 28, at 11. (35.) See Hungarian Act VI of 1990 on Issuing and Public Broking of Certain Securities and on Stock Exchange, Hungarian Rules of Law in Force 447 (1990) (creating the legal framework for a stock exchange in Hungary). The Act took effect February 1, 1990. As of April 1992, there were 48 members of the BSE. Powell, supra note 28, at 12. (36.) See The Guide to World Equity Markets, supra note 15, at 617. The Warsaw Stock Exchange was re-established on April 12, 1991, and trading in the first five privatized companies began on April 16, 1991. Id. at 621. The Prague Stock Exchange reopened on April 6, 1993. Patrick Blum, Prague Exchange to Open Today with Unlisted Market, Financial Times, Apr. 6, 1993, at 25. (37.) The minimum initial capital requirements for listing on the BSE is 221.6 million forints. Creating Capital Markets in Eastern Europe, supra note 9, at 47. The average exchange rate for July 1992 was 77.49 forints to the U.S. dollar, 74.735 forints to the dollar in 1991, and 63,206 forints to the dollar in 1990. International Monetary Fund, International Financial Statistics 266-67 (1993). The real effective exchange rates for the comparable periods were 103.2, 98.6 an 86.9 forints to the dollar, respectively. Id. Furthermore, an issuer must have completed at least one year in business. Only listed securities, as opposed to traded securities having less rigorous requirements, can be traded on foreign official markets. In 1992 the BSE was open for transaction activity only 90 minutes each day. Creating Capital Markets in Eatern Europe, supra note 9, at 65. (38.) A BSE index of leading companies started in 1991 with a base of 1000; it rose to 1250 in the fist few months before falling to 600 by autumn 1991. Phillip Moore, Hungary: Competition for Capital Likely to Intensify, Euromoney, Mar. 16, 1993, supp. at 135. Government issues accounted for 90% of trading. Id. at 136. (39.) Id. at 135. (40.) In 1991, the BSE transactions totaled only one-half of the volume of Hungarian shares on the Vienna Stock Exchange. Creating Capital Markets in Eastern Europe, supra note 9, at 65-66. At the end of 1990, of 460 Hungarian companies registered as share companies, 56, or 12%, were issuing or selling shares publicly. Id. at 50. Of this number, only 19 either listed or traded their stock on the BSE. Id. at 48. In April 1992, the number rose only to 21, nine of which also traded on the Vienna Stock Exchange. Nigel Ash, Hungary: The Gearbox Needs an Overhaul, Euromoney, Apr. 15, 1992, supp. at 47. In December 1991, Hungary issued its first long-term security, a three-year, floating-rate government bond. It pays the Hungarian 90-day T-bill discount rate plus 2%, currently 37% compared to an inflation rate estimated at about 30% in 1991. At the same time Hungarian Telecommunications Company made two issues of domestic bonds, each carrying a rate of 35% and selling quickly. Powell, supra note 28, at 11. The extent of Hungarian bond market activity mirrored, on a far smaller scale, the record levels in international bond activities in 1991, which reached $298 billion, compared to $230 billion in 1990. Private Market Financing, supra note 5, at 35. (41.) The Prague Stock Exchange opened on April 6, 1993. Blum, supra note 36, at 25. (42.) The month-to-month inflation rates through 1992 consistently held at below 1%. See Powell, supra note 28, at 13. (43.) The first domestic T-bill auction was held in Czechoslovakia on February 19, 1992. The federal T-bills, pre-separation, carried an

annualized yield of 12.6%, while the T-bills issued by the soon-to-be separate Czech Republic carried a 10.7% yield. Id. (44.) In mid-March of 1993, the Czech Republic government said it would stop issuing shares in Czech companies acquired by Slovaks under the mass privatization plan of 1992, whereby shares on a federation-wide basis were distributed through vouchers. Czechs and Slovaks: Not So Amicable, Economist, Apr. 17, 1993, at 50,50. Slovaks hold approximately $870 million of assets that Czechs say belong to them, and the Czechs threatened to seize Slovak assets in the Czech Republic. id. This dispute understandably has forestalled stock market trading. Id. With the major areas of dispute mostly resolved, the Czech Republic's privatization process has been largely successful, with trading of shares in more than 900 privatize companies on the Prague Stock Exchange beginning in June 1993. See Jiri Pehe, The Czech Republic: A Successful Transition, RFE/RL Res. Rep., Jan. 1994, at 72-73. (45.) Warsaw Stock Exchange: Back in the Game, The Warsaw Voice, Nov. 8, 1992, available in LEXIS, World Library, ALLNWS File, at 1. The new Warsaw Stock Exchange is modeled closely after the Paris Bourse. Id. (46.) As of April 1992, 11 stocks were listed on the Warsaw Stock Exchange, a number expected to grow by at least one a month. In 1989, Bank Gospodarstua Krajowego acted s lead manager for a bond offering that carried an annual fixed interest rate of 60%. (47.) The Zagreb Stock Exchange began operations on March 27, 1992 with only one product, a DM5 million bond issued on behalf of the Jadranka tourism company that carried a 12% annual yield coupon. Current civil strife in Yugoslavia has effectively precluded and further development of market activity. An Exchange in Embryo - Croatia, Euromoney, May 1992, supp. at 30. (48.) Ukraine has experienced a rapid growth of commodity exchanges, trading in anything from women's clothing to raw materials. The first such exchange was founded in November 1990. Shares in companies are traded on five of the Ukrainian exchanges. The larger commodity exchanges are expected to evolve into Western-styled stock exchanges. Breaking Up is Hard to Do, Euromoney, Jan. 1992, at 22-27. (49.) For a general discussion of the reasons to promote equity financing, see John Floegel, Equity Financing for Public Corporations: Reasons and Methods to Encourage It, 138 U. Pa. L. Rev. 1411 (1990). (50.) A bond is a certificate or evidence of debt on which the issuing company or governmental body promises to pay bondholders as specified amount of interest for a specified length of time, and to repay the loan on the expiration date. Black's Law Dictionary, supra note 6, at 178. For the purposes of this Article, bond and debt markets are synonymous. For a general discussion of debt financing, see Thomas Lee Hazen, The Law of Securities Regulation 829 (2d ed. 1990). (51.) For a general discussion of the effect of inflation on interest rates, see Maurice D. Levi, International Finance: The Markets and Financial Management of Multinational Business 47 (1990). (52.) See, e.g., Creating Capital Markets in Eastern Europe, supra note 9. In 1991, McDonald's Hungary made a private placement of bonds amounting to 400 million forints with a four-year maturity and an average annual interest rate of 27%, despite Hungary's average inflation rate of 35% in 1991. Powell, supra note 28, at 11. There has been an increase in the last two years, led by Hungary, in the issuance of Eurobonds to pay foreign debt and bolster foreign exchange reserves. See id. at 15. In 1991, of the $1.4 billion was attributed to bond issuances. Creating Capital Markets inn Eastern Europe, supra note 9, at 35. (53.) A bond is generally considered a junk bond if it is below investment grade as determined by one or more investment rating services. Robert W. Hamilton, Fundamentals of Modern Business 456 (1989). (54.) Typical matters voted upon by U.S. corporate shareholders include board of director elections, major acquisitions, and amendments to articles of incorporation. See generally Harry G. Henn & John R. Alexander, Law of Corporation 951-1018 (2d ed. 1983) (containing a general explanation of U.S. corporate matters, with specific treatment of shareholders voting rights). (55.) In fact, debt and equity markets compete for domestic savings and foreign capital, particularly as government debt is refinanced and the demands of the corporate sector increase in nations such as

Hungary. See Phillip Moore, Hungary: Competition For Capital Likely to Intensify, Euromoney, Mar. 16, 1993, supp.at 133. (56.) See generally John Vickers & George Yarrow, Privatization: An Economic Analysis 171-94 (1988) (discussing issues raised by sale of state assets, including pricing of shares, consequences for wealth distribution, and effect on government finances). (57.) See generally Privatization, Everybody's Doing It Differently, The Economist, Dec.21, 1985, at 71-86 (describing methods used by various nations to implement privatization programs). (58.) See Josef C. Brada, Working Group 3: Creating Capital Markets, in Comrades Go Private 159 (Michael P. Claudon & Tamar L. Gutner eds., 1992). (59.) Id. (60.) Privatization, for the most part, began in 1988. For a detailed discussion of the evolution of privatization and economic reform in Hungary, see Tamas Sandor, Privatization in Hungary: Questions and Problems, in Privatization in Central and Eastern Europe 23-24 (Peter Sarcevic ed., 1992). Hungary had experimented with market economic reforms for more than two decades prior to officially implementing comprehensive privatization between 1988 and 1990. Its private sector had grown slowly but steadily since 1982. See Gerd Schwartz, Privatization: Possible Lessons from the Hungarian Case, in World Development 1731-32 (Dec.1991). In 1985, the government introduced a self-governing organizational structure for state enterprises providing for the coexistence of two types of state-owned enterprise: "self-managed" firms controlled by enterprise councils, and "administratively managed" firms controlled by ministries and other state bodies. Id. at 1732. (61). Hungarian Company Act, Act No. VI of 1988 on Business Organizations, as amended by art. 49, para. 5 of Act No. LXV of 1991 and chap.1 of Act No. LV of 1992. 3 Hungarian Rules of Law in Force 167, 1445 (1992) [hereinafter Company Act]. (62.) See Catherine M. Sokil,Hungary's Economic Transformation, in Comrades Go Private 30 (Michael P. Claudon & Tamar L. Gutner eds., 1992). (63.) The Company Act did, however, allow freedom of enterprise whereby anyone, including private persons, could form a business association simply by registering it without approval form the Ministry of Finance. The act is the first legal code that uniformly governs and regulates all forms of business companies or economic associations. Id. (64.) Id. at 34. (65.) Act No. XIII of 1989 on the Conversion of Economic Organizations and Business Associations (Hung.) [hereinafter Transformation Act]. (66.) See Robert L. Drake, Legal Aspects of Financing in Czechoslovakia, Hungary and Poland, 26 Int'l Law. 505, 515 (1992). (67.) The SPA was established as the central governing organ for the exercise of owner rights and the privatization of state-owned enterprises. See Act No. VII of 1990 on the State Property Agency and on the Management and Utilization of Property Belonging to its Scope, as amended by Act No. LII of 1990 (Hung.) [hereinafter Hungarian SPA Act]. (68.) Schwartz, supra note 60, at 1732. (69.) See generally Ash, supra note 40, at 41 (describing the extreme caution with which Hungary has implemented its privatization program). (70.) The test case for SPA-initiated privatization was the stock offering of Ibusz, the Hungarian travel agency, in which more than one-third of the company's shares were sold to the public and listed on the Budapest and Vienna Stock Exchanges. See Moore,supra note 55, supp. at 135. (71.) See Ash,supra note 40, at 41. (72.) Jackson, supra note 9, at 62. (73.) See Ash,supra note 40, at 41. (74.) See Hungarian SPA Act, supra note 67; Hungarian act VIII of 1990 on Protection of Property Entrusted to State Enterprises [hereinafter Hungarian Protection Act]. (75.) Non-SPA-initiated privatization have accounted for approximately six percent of total state-owned property privatizations in the period 1988 through 1991. Moore, supra note 53, at 9. (76.) See Ludvik Kopac, Privatization of the State Economy in Czechoslovakia, in Privatization In Central And Eastern Europe 57 (Petar Sarcevic ed., 1992). The value of enterprises (large-scale only) scheduled to be sold off in accordance with the Conditions Acts amounts to an estimated $14.7 billion dollars. See World Equity Markets, supra note 15, at 610. (77.) Law No. 427 of 15 October 1990, the Act on the Transfer of the State Ownership of Some Property to Other Juridical or Natural Persons. This act provides for 75 regional committees to oversee the

privatization of small businesses through auctions. The first round of auctions was reserved only for Czech nationals. See generally Drake, supra note 66 (discussing recently enacted laws governing privatization in Czechoslovakia, Hungary, and Poland). (78.) Law No. 92 of 26 February 1991, the Act on Conditions of Transferring State Property to Other Persons [hereinafter Conditions Act]; see Vratislav Pechota, Privatization and Foreign Investment in Czechoslovakia: The Legal Dimension, 24 Vand. J. Transnat'l L. 305, 307 (1991). That law required an approved privatization project to be prepared for each enterprise. Such plan is to include the following detailed information:

1) description of the enterprise and the accompanying properties; 2) details on the way the state acquired the property; 3) details on any restitution claims by previous owners; 4) valuation of the property; 5) proposed manner of privatization, and 6) details concerning the company which proposed to take over the enterprise.

See Conditions Act, supra note 78; see also Drake, supra note 66, at 507.

(79.) See Powell, supra note 28, at supp. 14. As of April 1992, eight million Czechs had purchased these books. Id. Approximately two-thirds of voucher purchasers have given control of their vouchers to a private investment fund. See Paul Sacks, Privatization in the Czech Republic, 28 Colum.J. World Bus. 188 (1992). (80.) After initial rejection by its parliament, Poland finally approved a plan to privatize the bulk of state-owned industries and distribute their shares to the public on May 7, 1993. See Poland Senate Approves Privatization on Industries, Seattle Times, May 8, 1993, at A5 [hereinafter Poland Senate]. Obstacles to the plan included domestic resentment of foreign control and fears that privatization will result in widespread lay-offs. John Darnton, Polish Parliament Rejects Bill to Privatize Industries, N.Y. Times, Mar. 19, 1993, at A3. Under the Polish plan, 60% of the shares in 600 state enterprises will be turned over to 20 mutual funds; workers will be given 15% of the remaining shares and the governmen treasury will retain 20%. See Poland Senate, supra, at A6. Polish privatization has been oveseen by the Ministry of Ownership Changes, which has divested shares in state-owned enterprises through pulic auctions, public offerings, and negotiated sales. See Steven Velkei,An Emerging Framework for Greater Foreign Participation in the Economics of Hungary and Poland, 15 Hastings Int'l & Comp.L. Rev. 695, 719-20 (1992). The legal framework for Polish privatization is contained in a series of acts passed by the Polish Parliament in 1990. See Act of 13 July 1990 on the Privatization of State-Owned Enterprises, reprinted in 29 I.L.M. 1226 (1990) [hereinafter Polish Privatization Law]; Act of 9 November 1990 on the Extension of Operation of the Privatization of State-Owned Enterprises Act; Act of 13 July 1990 on the Establishment of the Office of the Minister for Ownership Transformations. In Ukraine, the main privatization program was scheduled to begin in 1993, with both large and small businesses being sold. See Breaking Up Is Hard to Do, Euromoney, Jan. 1992, at 22. According to plans, a portion of the shares of each company would be distributed free to Ukrainian citizens. Id. Approximately 500 companies that did not require demonopolization were scheduled to be sold off in 1992. Id. For the most part, privatization of large enterprises in most of the older former Soviet republics as expected to get under way in 1993 and 1994. See International Monetary Fund, Economic Review: Common Issues And Interrepublic Relations in the Former U.S.S.R. (1992). (81.) See Serge Schmemann, To Each According to His Shares, N.Y. Times, Dec.14, 1992, at D1, D6.; Russia Turning Capitalist in its Own Peculiar Way, Seattle Post-Intelligencer, Feb. 9, 1993, at A4. (82.) See Russia's New Corporate Raiders, Privatization Int'l, Sept.1993, available in LEXIS, World Library, ALLWLD File. Under another method of privatization, employees can acquire non-voting, preferred shares of stock equal to 25% of firm's value without charge. They would then have the right to purchase common stock equal to 10% of the firm's equity at a 30%m discount from nominal value; employers in enterprises with fewer than 200 employees can purchase 20% of equity at

a 30% discount and hold voting rights over another 20% of the firm's stock. See State Program for Privatization of State and Municipal Enterprises in the Russian Federation for 1992, Decree No. 2980-1 (June 11, 1992), available in LEXIS,Nexis Library, ALLEUR File. The Czechoslovak Plan, on which the Russian Plan was modeled, does not contain a similar reservation of shares for enterprise employees. See Kopak, supra note 76, at 62-63. (83.) Schmemann, supra note 81, at C1. There is increasing evidence, however, that the managers and employers of Russian firms are either seeking to acquire the maximum possible control of an enterprise's stock by purchasing more than their 51% allocated share in the secondary market, or are acting on behalf of outside investors to whom they have committed to sell to their 51% interest. See Judith Thornton,Privatization and Financial Markets in the Russian Far East (1993) (unpublished manuscript, on file with the Univ. of Wash. Dept. of Economics); Russia's New Corporate Raiders, supra note 82. (84.) In Hungary and Poland,investment banks and international accounting firms have been engaged for a fee to facilitate the conversion process. Jackson, supra note 9, at 60. See also Teresa B. Mastrangelo & Robert J.F. McPhail,Saving Those Going Private: The Role of Accountancy in Privatization, 28 Colum.J.World Bus. 206(1993). (85.) As of summer 1992, 75% to 90% of the industries in Hungary and Poland were still state-owned. See Moore, supra note 55, at 12. (86.) For example, in the first three quarters of 1992, only 18 equity sales of privatized enterprises occurred in Poland. Only one of the sales was made by a public offering. See Progress Report on Privatization, Polish News Bulletin, Dec. 22, 1992, available in LEXIS, Nexis Library, CURRNT File. (87.) Czechoslovakia and Poland have adopted a combination of the two approaches, while Hungary favors the sale approach. See Gros & Steinherr, supra note 21, at 7. (88.) See, e.g., id.at 12. (89.) Id. (90.) For a more detailed discussion of the arguments against a partial or complete giveaway shares, otherwise known as the free transfer model, see David P. Ellerman et.al. Privatization Controversies in the East and West, in Comrades Go Private, supra note 62, at 123. (92.) See Pechota, supra note 78, at 307. (93.) Comrades Go Private, supra note 62, at 2. (94.) The deputies of Poland's parliament who initially voted against the recent privatization plan primarily opposed foreign control of Polish companies. See Polish Parliament Rejects Bill to Privatize Industries, supra note 80, at A3. (95.) Id.; see also Creating Capital Markets in Eastern Europe, supra note 9, at 35. In fact, 60% to 80% of the market activity on the Budapest Stock Exchange is attributable to foreign investors. See Powell, supra note 28, at 12. (96.) Pechota, supra note 78, at 307. (97.) See Dickie & Layman, supra note 7, at 168. (98.) For example, in Czechoslovakia, approval from the Ministry of Civil Engineering and Construction is required for foreign investment in most engineering firms. See Drake, supra note 66, at 507. The Polish Foreign Investment Law, although enacted to substantially reduce government intervention in foreign investment, retains the government's authority to approve foreign investment in areas of the economy that have traditionally involved state interests, including harbors, airports, real estate brokering, defense industry, and the wholesale trade of imported consumer goods. See Polish Foreign Investment Law, art. 4(1) (1991), reprinted in 30 I.L.M. 871, 875-78 (1991). The Amended Hungarian Foreign Investment Law eliminates any government authorization for foreign investment unless a foreign investor purchases an interest in a privatized enterprise with consideration other than capital. Compare Act XXIX of 1988 on the Amended Hungarian Foreign Investment Law, [sections] 9(2), reprinted in 2 H.R.L.F. 305, 307 with Act XCVIII of 1990 on the Amendment to Act XXIX of 1988 on Investments by Foreigners in Hungary, para. 1, reprinted in 2 H.R.L.F. 190, 190. (99.) See Hungarian Act XCVIII, supra note 98, [sections] 13(2), 2 H.R.L.F. 190 (repealing prohibition against acquisition of a controlling interest in a domestic company by a foreign controlled company). Czech law allows foreigners to hold shares without any substantive restrictions except that such shares must be registered. See Act VI on Business Organizations; see also Polish Foreign Investment Law,

supra note 98, arts. 1, 3, 4, 6.The Polish Foreign Investment Law, however, permits the Ministry of Ownership Charges to establish a ratio between Polish and foreign parties' share capital of a company or the ratio between votes at the shareholders' or partners' meetings for the "protection of state interests." Id. art. 16(2). (100.) See, e.g., Hungarian SPA Act, supra note 67, art. 25(2); Hungarian Protection Act, supra note 74, art (1)(1) (limiting government involvement by requiring government authorization for the proper valuation of state assets). Cf. Amended Hungarian Foreign Investment Law, supra note 98 (containing no such provision). The Polish Foreign Investment Law, however, specifically repealed all provisions of the Polish Privatization Law pertaining to foreign investment and thereby became the sole reference for rules pertaining to foreign ownership of any enterprise in Poland. See Polish Foreign Investment Law, supra note 98, art. 33, reprinted in 30 I.L.M. at 881. (101.) See, e.g., The Presidential Emergency Decree for Economic Stability and Growth of 1972. Corporations in Korea are required to distribute publicly at least 30% of the total number of shares outstanding; controlling shareholders are encouraged to lower their shareholdings from 51% to 30%. See Chung, supra note 8, at 38; Dickie & Layman, supra note 7, at 170. (102.) See Chung, supra note 8, at 38-39. (103.) Id. (104.) Korean Act Relating to Capital Market Support art. 7 (1967). (105.) Dickie & Layman, supra note 7, at 171. (106.) Chich-Heng Kuo, International Capital Movements and the Developing World - The Case of Taiwan 172 (1991). (107.) For discussion of overvaluation, see Powell, supra note 28, at 12. This phenomenon contrast with wildcat or spontaneous privatizations, where assets are sold at ridiculously undervalued prices. Local citizens tend to find the sale of shares to foreigners palatable if measures are in place to prevent the shares from being sold too cheaply. No Eastern European government wants to create an environment, that might allow the wildcat privatizations that occurred in Hungary at the beginning of its privatization efforts. See Sokil, supra note 62, at 30; Schwartz, supra note 60, at 1732. 1734. In one of example of undervaluation, the Polish government was recently accused of egregiously undervaluing the shares of Bank Slaski, whose jumped in one day from an initial offering price of $23 to $313. See Polant Faulted on Sell-off, Wall St. J., Jan. 27, 1994, at A10. (108.) Hungarian and Polish privatization authorities have in fact utilized the services of investment banks and international accounting firms. See Creating Capital, Markets in Eastern Europe, supra note 9, at 60; Mastrangelo & McPhail, supra note 84. (109.) See Schwartz, supra note 60, at 1733. In comparison, on the Ukraine Stock Exchange, the Western concept of equity dilution has not taken hold, as evidenced by the continued trading of Inco Bank shares at the initial par price of 1000 rubles notwithstanding subsequent issuances of new shares. See Breaking Up Is Hard To Do, supra note 80, at 26. (110.) Hungary has included a provision in its privatization law intended to monitor proper valuations in a small proportion of transactions. The government must approve any foreign non-financial contribution for more than 10% of the assets of a privatized enterprise, where the amount of the contribution exceeds 20 million Hungarian forints. Hungarian Protection Act, supra note 74, para. 1(1)(a). This provision, neither included nor referenced in the Amended Hungarian Foreign Investment Lay, services as another reason to read privatization and foreign investment laws in conjunction with each other. (111.) Powell, supra note 28, at 13. (112.) Coercing foreign companies into offering equity shares can backfire, however. For example, when pressed in the late 1970s to take on local shareholders, both Coca-Cola and IBM ceased doing business in India. See Dickie & Layman, supra note at 146 47. Most foreign-owned companies operating in developing countries resist calls to go public that are unaccompanied by incentives. See Chung, supra note, 8, at 39. (113.) See generally Shahrokh Saudagaran, An Empirical Study of Selected Factors Influencing the Decision to List on Foreign Stock Exchanges (1986) (unpublished Ph.d. dissertation, University of Washington). (114.) Generally, the time and expense involved in complying

with foreign stock exchange, and regulatory registration requirements varies from country to country. Standard transaction costs include prospectus costs and lawyer and accountant fees. (115.) See World Equity Markets, supra note 15, at 612. (116.) For a detailed discussion on how reciprocal disclosure requirements work, see U.S. Sec. and Exch. Comm'n, Internationalization of the Securities Markets 74-87 (July 27, 1987). (117.) For example, a number of foreign financial funds, including those from international agencies, have been established in the region. "In 1991, the Boston-based Pioneer Group filed the first application to Poland's Securities Exchange Commission for permission to set up a fund aimed at ultimately investing up to $100 million from Polish investors." Creating Capital Markets in Eastern Europe, supra note 9, at 66. (118.) A broad market for equity shares is necessary for the efficient allocation of capital because it ensures efficient valuation of shares. See, David P. Ellerman et al., Privatization Controversies in the East and West, in Comrades Go Private, supra note 62, at 117, 125-29. (119.) Richard L. Holman, Free Markets Opposed in Poll, Wall St. J., Feb. 25, 1993, at A10. (120.) Id. The survey polled 18,500 people in 18 countries in Central and Eastern Europe and the former USSR. (121.) See Creating Capital Markets in Eastern Europe, supra note 9, at 9. (122.) See, e.g., Manohar Krishna Shrestha, Securities Exchange Centre Problems and Prospects (1986) (discussing problems faced by stock exchange in Nepal). (123.) Bruce Lloyd, The Role of capital Markets in Developing Countries, in Intereconomics 96 (1977). (124.) For a concise discussion of the mobilization of domestic savings for investments, see Hungary: Competition For Capital Likely to Intensify, Euromoney, Mar. 16, 1993, at 133. (125.) For example, in the area of debt financing, the Polish government plans to issue one-to-three-year floating rate notes in small denominations particularly to attract small investors. See Powell, supra note 28, at 14. (126.) For example, in Korea individual investors may pay monthly installments for stocks they plan to purchase or have already purchased. See Dickie & Layman, supra note 7, at 178. In the recent issue of Danubius, a Hungarian hotel group, investors were asked only to put down 10% of the issue price, with an additional 40% to be paid after six months and the balance financed through cheap credit. See Hungary: Competition For Capital Likely to Intensify, supra note 1 24, at 136. (127.) See Schwartz, supra note 60, at 1735. (128.) Id. (129.) For a detailed discussion of employee ownership of shares in privatized companies, see Privatization in Central and Eastern Europe, supra note 76, at 33-34 (Hungary). See also Mario Nuti, Privatization of Socialist Economies: General Issues and the Polish Case, in Transformation of Planned Economies, supra note 3, at 62 (Poland). (130.) For example, a recent public sale of previously state-owned property in Russia guaranteed workers in the Bolshevik bakery 51% ownership. See To Each According to His Shares, supra note 81, at D1. (131.) See Pechota, supra note 76, at 3 12. Similarly, Hungarian workers are generally offered no price concessions for shares in their companies. When Ibusz was privatized, the only concession granted to workers was the ability to pay for their shares in installments. See Schwartz, supra note 58, at 1735. Hungarian law provides employees with tax and credit preferences so they can extend payments for shares. See Development of Employees' Share Ownership, Summary of Word Broadcasts, Mar. 18, 1993, available in LEXIS, Nexis Library, NEWS File (Hungarian Telegraph Agency broadcast, Mar. 12, 1993). In comparison, Croatian employees were generally given the first right to buy shares at up to a 50% discount. See An Exchange in Embryo - Croatia, supra note 47, at 34. (132.) See Polish Law on Privatisation of State-Owned Enterprises, art. 24, translated in Privation in Central and Eastern Europe, supra note 76, at 186. However, the plan to implement the legislation, approved by the Polish parliament, provided for the reservation of 15% of the shares in an enterprise for workers. See Patricia Koza, Government Wins Privatization Vote, UPI, Apr. 30, 1993, available in LEXIS, World Library, CURNWS File. (133.) Taiwan, for example, opened its market to foreign investors, despite sufficient domestic savings to support

its stock market, simply to enlarge the stock exchange's scale of operations. See Kuo, supra note 106, at 172. (134.) See generally Chung, supra note 8, at 37-38. (135.) Foreign concerns with the underlying economic situation in the region are justified in some cases. For instance, Poland and Bulgaria defaulted on their debts. Creating Capital Markets in Eastern Europe, supra note 9, at 40. Nevertheless, in March 1991, Poland obtained 50% forgiveness of its debt from the Paris Club of official creditors. Id. Many former Soviet republics have effectively defaulted on trade credits and other short-term debt commitments and are in the midst of a liquidity crisis. Id. Albania is one of the few countries ever to have defaulted on its spot currency transactions. Id. (136.) Hungary has been particularly successful. During 1990 to 1991, 28% of new Hungarian businesses were formed with the participation of foreign capital. Id. at 50. Also, foreign investors constitute 60% to 80% of trading activity on the Budapest Stock Exchange. See Powell, supra note, 28, at 12. This foreign involvement may be due to the fact that Hungary has been steadfast in servicing its $21.3 billion debt. Creating Capital Markets in Eastern Europe, supra note 9, at 40. Czechoslovakia, which has also managed to attract relatively high levels for foreign investment, has retained good credit standing from its conservative approach to debt financing. Id.; but see supra note 76 (discussing the situation in Slovakia). Poland, which surmassed an intimidating debt load, has received relatively small foreign capital inflows, mostly in the form of joint ventures, amounting to $200 million by March 1990. See Nuti, supra note 3, at 64. (137.) See Steven A. Crown, Western Investors with Eye on Russia Should be Cautious, Seattle Post-Intelligencer, Dec. 30, 1 992, at A7. (138.) ld. (139.) Id. For a first-hand perspective on this problem, see Alfred E. Belcuore, Meeting the Founders: Russians and Kazakhs Work for Democracy, 25 Law & Pol'y Int'l Bus. 461 (1994). (140.) Creating Capital Markets in Eastern Europe, supra note 9, at 44. (141.) See text accompanying supra note 16. (142.) See Dickie & Layman, supra note 7, at 169-70. (143.) Even in Hungary, which began market economic reforms twenty years ago under the Communist regime, two-thirds of the work force were government employed and more than 75% of the country's assets were still owned by the state in 1991. See Philip R. Lochner, Planning for Spontaneity: The Creation of Free Markets in Eastern Europe, 17 Brooklyn J. Int'l L. 363, 368 (1991). (144.) Arguably, other laws, such as exchange regulations and bankruptcy laws, also comprise an integral part of the infrastructure, but they tend to emanate from and supplement these four basic sets of laws. (145.) Hungary's company law is typical of Eastern European laws addressing business organizations. See Company Act, supra note 61, at 3. The company law in Hungary sets forth six forms of legal business entities. Of the six, "companies limited by shares" are best structured for public stock offerings, insofar as shares of stock represent company, capitalization. Id. at 71. The law incorporates a number of corporate traits that allow the companies to operate as publicly held companies in accordance with Western standards. These traits include limitations on shareholder liability and the right of shareholders to elect the board of directors, a supervisory board, and an auditor of the company. Id. at 78. Shares may be issued at a premium and may take bearer or registered form, although foreigners can hold only registered shares. Id. at 72-73. Notably, shareholders are liable only to the extent of their original investment. Id. at 70. Laws governing business organizations are incorporated into the Czechoslovakian Commercial Code, which went into effect January 1, 1992. The new Commercial Code replaced or incorporated the Economic Code, the Joint Stock Companies Act, the Foreign Trade Code, and the Act on Enterprises with Foreign Property Participation. Czech Commercial Code, Act No. 513, ch. 2, [subsections] 56-260, translated in Digest of Commercial Laws of the World 93-101 (L. Nelson ed., 1992) [hereinafter Czech Commercial Code]

Of the various forms of business the laws regulate, the joint stock company, appears most similar to a Western corporation that can offer its shares publicly. A joint stock company is a company whose capital is

divided among certain number of shares of certain nominal value. The shareholder does not bear liability for the obligations of the company. Shares are registered as bearer or registered shares. More than one person may own shares, and all shareholders are entitled to a portion of the company profits. The highest body of the joint stock company is the general meeting of shareholders. Id. (146.) In the United States, Regulation S-K specifies the items of non-financial information required to be disclosed in a prospectus. See Adoption of Disclosure Regulation, Securities Act Release No. 5893, 13 Sec. Dock. 1217 (Dec. 23, 1977); see generally 2 Louis Loss &, Joel Seligman Securities Regulation 620-87 (1989) (discussing data requirements of the Sec's Registration Statement and Prospectus as set forth in Regulation S-X). See Adoption of Disclosure Regulation, Securities Act Release Nos. 6233 & 6234, 20 Sec. Dock. 1155, 1156 (Sept. 2, 1980). (147.) See, e.g., Council Directive 80/390, 1980 O.J. (L 100) 1 (Listing Particulars Directive); Council Directive 89/298, 1989 O.J. (L 124) 8 (Public Offering Directive). (148.) Hungary's basic securities law, which attempts to establish the legal framework for stock exchanges, went into effect on February 1, 1900, Act VI of 1990 on the Public Offering of Securities and the Stock Exchange, H.R.L.F. (May 1, 1990) [hereinafter Hungarian Securities Act], translated in U.S. Dep't of Com., Central and Eastern European Legal Materials: Hungary (1990). Public offering require a prospectus that sets forth information regarding management, business operations, financial data not more than six months old and certified by auditors, and risk factors, among other things. Before a company can issue shares to the public, the offering prospectus must be approved by the Securities Supervisory Board. Id.; see also Drake, supra note 66, at 516.

Poland's law to regulate securities activities, adopted by the Polish Parliament on March 22, 1991, contains similar provisions. See Polish Act on Public Trading of Securities and Trust Funds (Oct. 9, 1991) [hereinafter Polish Securities Act], translated in U.S. Dep't of Com., Central and Eastern European Legal Materials: Poland (1992). Poland's securities law requires companies admitted to trading on the Warsaw Stock Exchange by the Polish Securities Commission to supply a prospectus that complies with the requirements drawn up by the Council of Ministers. The required information is intended to allow investors to "asses the assets of the issuer and its financial resources, prospects of development, profits and losses and the rights associated with securities which are traded on the market." Id.

The laws regulating securities transactions in Czechoslovakia are still in their embryonic stage. Since the Prague Stock Exchange opened in April 1993, these laws have yet to be tested. Prior to separation, the Czech Federal Assembly enacted a law that purports to be a securities law, but regulates only the issuance of bonds and other debentures. See Act No. 528 of the Foreign Exchange Act (1990), translated in 2 Central and Eastern European Legal Materials 530 (V. Pechota ed., 1990). Legislation addressing other area of securities trading, particularly stock issuances and the establishment and operation of stock exchanges, was finally adopted in 1992 both by the Czech Republic and the federal government. See Czech Republic, East Eur. Bus. L., Mar. 1993, at 3. The new laws purportedly conform with relevant European Community directives. See World Equity Markets, supra note 15, at 612. These laws still fail to address some key areas of stock trading, most notably takeovers. See Large Scale Privatization: Some Important Features for Foreign Investment, East Eur. Bus. L., Apr. 1993, available in LEXIS, Nexis Library, PAPERS File. (149.) See James F. Strother, The Establishment of Generally Accepted Accounting Principles and Generally Accepted Auditing Standards, 28 Vand. L. Rev. 201 (1975). (150.) See generally International Capital Markets, supra note 12, (analyzing structural changes and related policy issues in financial markets.) (151.) See Group of Thirty, Clearance and Settlement Systems in the World's Securities Markets (1989). The Group of Thirty represented an international initiative to harmonize clearance and settlement procedures in industrialized and developing countries. Its recommendations were to be

implemented by the end of 1992. (152.) For example, trades are generally settled within five days in the United States. See International Capital Markets, supra note 12, at 24. In some markets, settlement may take several weeks. Group of Thirty, supra note 151, at 1. (153.) Group of Thirty, supra note 151, at 69. (154.) For example, the International Monetary Fund has discerned the need in the former republics to overhaul the clearing system that has become segmented since the dissolution of the USSR. See International Monetary Fund, Economic Review: Common Issues and Interrepublic Relations in the Former USSR (1992). (155.) Creating Capital Markets in Eastern Europe, supra note 9, at 48. (156.) Id. (157.) Dematerialization refers to the trade of paperless securities. (158.) World Equity Markets, supra note 15, at 613. (159.) See International of the Securities Markets, supra note 116, at 18. (160.) Dickie & Layman, supra note 7, at 178. (161.) Id. (162.) See Hungarian Securities Act, supra note 148; Creating Capital Markets in Eastern Europe, supra note 9, at 48. The National Bank of Hungary, however, must also authorize Hungarian issuers to trade their stock outside the country and foreign issuers to trade stock in Hungary. Id. (163.) See Creating Capital Markets in Eastern Europe, supra note, 9, at 48. In Poland, the Polish Securities Act provides the legal basis for the establishment of a securities commission to oversee the Warsaw Stock Exchange and securities markets. See Polish Securities Act, supra note 148; see also The Warsaw Stock Exchange: Back in the Game, The Warsaw Voice, Nov. 8, 1992, at 1, available in LEXIS, World Library, ALLNWS File. (164.) Pechota, supra note 78, at 319 n.37. To protect investors, draft legislation provides for a supervisory body based upon the U.S. Securities and Exchange Commission. See World Equity Markets, supra note 15, at 612. (165.) See Evelyn Iritani, Taking Stock in Russia - A High Risk Investment, Seattle Post-Intellingencer, Apr. 9, 1993, at C1. (166.) Capital flight also may be defined as "the component of private capital outflows [from a nation] resulting from attempts to exceptional sacrifices on rates of return [in that nation]." Exchange and Trade Relation Dep't of the Int'l Monetary Fund, Private Market Financing for Development Countries 29 (1991). Flight, should be distinguished from normal capital outflows related to higher interest rates of return including foreign bond and portfolio investments, overseas commercial bank lending, and foreign bond investment. For purposes of this Article, capital flight includes all flight of capital from a nation, including a normal flight. (167.) If they anticipate currency devaluation, whether by government action or depreciation, investors with stock and dividends payable in the domestic currency those assets into another currency, gold, or both. In this way, investors avoid any exchange rate losses that might outweigh expected profit. The volatility of exchange rates in emerging markets, particularly where currency is depreciating at extraordinary rates, requires that the return on the underlying asset outweigh the currency's depreciation. See Michael R. Sesit, Currency Traps in Emerging Markets, Wall St. J., Mar. 15, 1993, at C1. (168.) Specualation is the deliberate undertaking of a risky venture with the hope of making a profit from exchange rate movements. See Levi, supra note 51, at 123-24. (169.) John T. Cuddington, Capital Flight: Estimates, Issues and Explanations, 58 Princeton Stud. Int'l Fin. 10-12 (1986). (170.) See id. at 14-15; Donald R. Lessard & John Williamson, Capital Flight and Third World Debt (1987). (171.) For a more detailed explanation of the relationship between interest and exchange rates, see Levi, supra note 51, at 107-08. (172.) See id. (173.) See generally Benu Varman-Schneider, Capital Flight From Developing Nations (1991) (explaining overall borrowing decisions of developing countries and defining, measuring, and explaining the phenomenon of continual capital exportation). (174.) See Cuddington, supra note 169, at 13. (175.) However, it cannot be categorically assumed that the bulk of capital resources, if retained domestically, would be allocated to growth-inducing investment. See generally Lessard & Williamson, supra note 170, at 201 (1987) (examining policies that impact on capital exchanges). (176.) See Cuddington, supra note 169, at 33. Some scholars believe, however, that

capital controls intended to stem the outflow of money generally are ineffective. See, e.g., Dickie & Layman, supra note 7, at 29. (177.) See Lessard & Williamson, supra note 170, at 21. (178.) See id. (179.) Articles of Agreement of the International Monetary Fund, arts. VI(3) & VIII (1988) (as amended), reprinted in John H. Jackson & William J. Davey, Legal, Problems of Internationl Economic Relations 109, 136-37 (Supp. 1989). Although the IMF generally obligates its members not to impose restrictions on payments or transfers for current account transactions and not to engage in discriminatory currency arrangements, the transitional arrangements of Article XIV of the IMF Agreement permit about 100 developing nations to engage in discriminatory foreign exchange controls and implement capital flight restrictions. Articles of Agreement of the International Monetary Fund, supra, art. XIV. (180.) See Lessard & Williamson, supra note 170, at 235. (181.) See World Bank, Report to the Development Committee and Guidelines on the Treatment of Foreign Direct Investment (1992), reprinted in 31 I.L.M. 1363 (1992). While explicitly aimed at encouraging foreign direct investment, the guidelines incidently apply also to portfolio investment. Id. Not binding on World Bank members, the guidelines are meant to be "soft law" that does not rise to the level of a formal international agreement. Id. (182.) Specifically, the guidelines call for World Bank members, which include Hungary, Poland, the Czech Republic, and Slovakia, to apply national treatment to foreign investment and remove any impediment which has the effect of discouraging foreign investment. Id. art III. In addition to allowing the full repatriation of profits and liquidated investments, the guidelines call upon nations to "promptly issue licenses and permits" to allow foreigners to invest in their jurisdiction. Id. arts. III(5) & (6). Like the IMF Agreement however, the guidelines condone an exception to full repatriation "in exceptional cases where the State faces foreign exchange stringencies [sicl," but "such transfer[s] may as an exception be made in installments within a period whichwill be as short as possible and will not in any case exceed five years from the date of liquidation or sale." Id. art. III(6). (183.) Amnesty, the excuse of past exchange control and tax violations, may stimulate of inflows of foreign exchange and, to a lesser degree, broaden the tax base. See Private Market Financng, supra note 5, at 3 1. (184.) Since exchange rate risk is a prima factor motivating capital flight, contries may allow domestic assets including bank deposits and bonds to be denominated in a foreign currencn. Id. at 32. Yugoslavia has allowed such foreign-denominated instruments. Id. Ultimately, monetary policy issues may dissuade this practice. (185.) Additionally, an increasing number developing nations are issuing foreign-denominated securities, particularly Eurobonds. See id. (186.) See Hungarian Foreign Investment Law, supra note 98, art. 32(1); Polish Foreign Investment Law, supra note 98, arts. 25(1), 26(3)(1), reprinted in 30 I.L.M. at 883. Poland's old investment law allowed only 15% of local currency profits to be repatriated into hard currency. David Kennedy & David Webb, Integration Eastern Europe and the European Economic Communities, 28 Colum. J. Transnat'l L. 633, 636 (1990). Czechoslovakia passed similar legislation. See Enterprises with Foreign Property Participation Act of April 19, 1990, art. 20 [hereinafter Czech Foreign Participation Act], reprinted in 29 I.L.M. 1047, 1052 (1990). However, a Czechoslovakian only if it has sufficient foreign funds. Id. art. 20(2), reprinted in 29 I.L.M. at 1052. (187.) See, e.g., Treaty Between the United States of America and the Czech and Slovak Federal Republic Concerning the Reciprocal Encouragement and Protection of Investment, art. V, reprinted in U.S. Dept. of Commerce Central & Eastern European Legal Texts, Oct. 21, 1991 [hereinafter U.S.-Czech Foreign Investment Treaty]. Specially, that treaty does not contain the rule set forth in article 20 of the Czechoslovakia only if it adequate convertible currency earnings. Although Poland negotiated a similar treaty with the United that the U.S. Senate ratified on January 1, 1992, the Polish Sejm, its legislative body, has not yet ratified it. See Treaty Between the United States of America and the Republic of Poland Concerning Business and

Economic Relations, S. Doc. No. 18 101st Cong., 2nd Sess. (1990). Negotiations to consummate foreign investment treaty between Hungary and the United States have stalled due to Hungary's desire not to afford the United States as Favorable treatment as the European Community, to which it aspires to become a member. See U.S.-Hungary Investment Treaty Stalled, But Business Interest Remains Strong, Int'l Trade Daily (BNA), Apr. 28, 1992, available in LEXIS, Nexis Library, ALLEUR File. (188.) See, e.g., Hungarian Investment Law, supra note 98, art. 1(2); Polish Foreign Investment Law, supra note 98, art. 22; U.S.-Czech Foreign Investment Treaty, supra note 187, art. III. The problem associated with guarantees is determining convertibility. Although the guarantee requires compensation for any expropriated investment in the currency of the original investment at the prevailing market rate of exchange, determining that exchange rate in countries that do not yet have freely convertible currencies raises diffculties. (189.) See Eastern Europe Retains Barriers to Investment, Investment, Eximbank Official Says, Daily Rep. for Executives, Aug. 12, 1992, available in LEXIS, Europe Library, ALLEUR File. The slow pace of privatization and the lack of an established banking system are among the primary barriers preventing Eastern European countries from becoming fully integrated with the world economy, according to the Vice-Chairman of the U.S. Export-Import Bank. Id. (190.) See supra text accompanying notes 16-17. (191.) See Jane Perlez, Polish Cabinet Falls Over Tight Budget, N.Y. Times, May 29, 1993, at 3. The one-year-old government of Prime Minister Hanna Suchocka collapsed on May 29, 1993, when it lost a no-confidence vote called to protest her tight budget policies. Id. (192.) See, e.g., Joel Havemann, One Europe: The Dream of Unity, L.A. Times, Feb. 4, 1992, at 1;Alan Riding, European Community Sets Terms For Six Former Soviet Allies To Join, N.Y. Times, June 23, 1993, at A8; Anne Wagner-Findeisen, From Association to Acession - An Evaluation of Poland's Aspirations to Full Community Membership, 16 Fordham Int'l L.J. 470 (1992-93); Michael Spector, The European Community's Expansion Mechanism and the Differing Approaches of EFTA and Eastern Europe to Community Membership, 25 Law & Pol'y Int'l Bus. 335 (1993). (193.) For example, negotiations to consummate a foreign investment treaty between Hungary and the United States stalled to Hungary's reluctance to afford other nations as favorable treatment as members of the European Community. See U.S.-Hungary Investment Tready Stalled, supra note 187. (194.) For an analysis of some of the problems associated with a single European stock market, see Doreen McBarnet & Christopher Whelan, International Corporate Finance and the Challenge of Creative Compliance, in The Internationalization of Capital Markets and Regulatory Response 129, 135-36 (John Fingleton ed., 1993). (195.) See Matthew Valencia, Eastern Europe: Investment Funds - The Next Generation, Euromoney Central European, Mar. 1, 1993, available in LEXIS, Europe Library, ALLEUR File; Michael R. Sesit, New Index Fund Sails For Emerging Markets, Wall St. J., April 10, 1993, at C1.

Industry Codes/Names: GOVT Government and Law; INTL Business, International
Descriptors: Stock-exchange--Laws, regulations, etc.; Capital market--Laws, regulations, etc.; Privatization--Analysis
Geographic Codes: EE
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Abstract: As part of China's policy of economic liberalization, the Chinese have been moving cautiously into share ownership of business enterprises and regional money markets. The liberalization of the country's financial markets over the past three years has been partly inspired by the dramatic effect that share ownership had on the agricultural sector of the economy. The regional markets and the Chinese banks operating within them are described; regional markets have become so important that economists are predicting Beijing will give up its status as a financial center to Wuhan (a city on the Yangtze in central China). Many of China's financial planners concede that capital markets and securities trading can stimulate economic growth where central economic planning has failed, but Chinese officials are worried about speculation and corruption in the absence of strict government regulation. The future of economic reforms in China remains uncertain; there are rumors that Deng Xiaoping may retire after the Communist Party's national congress in 1987.

Text:

THE CHINA SYNDROME

"You foreign observers talk too much about the progress that China has made towards modernisation,' complained one of the most experienced economists with the Chinese Finance Ministry, "but our economic system remains extremely primitive.'

This senior cadre is one of an influential group that has been lobbying vigorously during the last three years for liberalisation of financial markets through freedom for banks to buy and sell funds and for the public to own shares and other securities.

"One of my main arguments in favour of share ownership of business enterprises,' he said, "is that in the western industrial revolution, the limited liability company played as important a part as the steamengine. Many of my comrades still can't grasp that simple concept.'

While many reformers are impatient at what they see as the stubborn Marxist-Maoist conservatism of so many of the 42 million members of the Chinese Communist Party, lower down the administration, officials boast of their dramatic advances towards a truly free commercial system.

"The hardest thing at present is to know which is really the "largest' or the "first' among the money markets that grew up in 1986,' joked a Beijing member of the Industrial and Commercial Bank. "The newspapers say that our bank's branch in Taiyuan, capital of Shanxi province, has the country's biggest money market and handles over 100 million renminbi (RMB) in transactions nationwide daily. I think other cities are even more active.' His own candidate for top money market was Guangzhou, capital of the southern Guangdong province next door to Hong Kong. This official thinks that Guangzhou is a more sophisticated market.

"What you can be certain of in China today,' explained a leading cadre from the People's Bank (China's central bank), "is that Beijing is no longer the financial capital. The system has become very decentralised and

about ten cities have money markets that compete and cooperate very independently with each other.' This source forecast that the biggest money market in China would eventually be Wuhan, an industrial city high up the Yangtze river in central China.

"We estimate that along the Yangtze, we have almost 30 cities, including Shanghai at the mouth of the river, which employ loan funds worth more than RMB100 billion,' ($26.9 billion) he explained, "Wuhan is the clearing house for inter-bank transactions between them, and you have to go to Wuhan if you are a city branch that has surplus funds to lend or a need to borrow.'

There has been a great deal of soulsearching within the Chinese Communist Party during the winter over the impact on the nation of a decade of economic reforms. Student demonstrations for greater democracy and a free press were seen by the more conservative Communist Party leaders as evidence that "bourgeois' and "capitalist' tendencies were being encouraged by economic liberalism.

"We have to admit that the number of beggars and of unemployable youths has grown very sharply since we started to move to our reforms based on market forces,' said a Shanghai Party official. "Not just in Shanghai but all the big cities because nobody is guaranteed a good job by the state and you get dropouts.' He also confessed that despite the announcement of draconian measures to eliminate venal officials, corruption and black markets still flourish.

"Even though we have made mistakes,' this official declared, "we cannot retreat from our financial reforms.' This conviction that a commercial system that spans the whole country is essential to shift funds to the areas which need them most--and are willing to pay market rates--is a constant refrain from prime minister Zhao Ziyang down. The explanation for this apparently universal acceptance within the ruling elite of a more capitalist financial regime than any known since the Chinese Communist Party came to power can be found in the results achieved compared with other sectors.

For example, during 1985, after six years of management reforms, a mere 15% of the country's major industrial enterprises were listed officially as "fairly active'. In the remainder, the reforms had achieved disappointing results. "But in a mere two years, the banks have achieved a financial revolution all over the country, and our money and share markets flourish,' noted an aide to People's Bank governor, Chen Muhua.

According to People's Bank economists, the performance of the money markets is the inevitable result of the switch by China away from a command economy, in which almost all economic activity was dictated by the central planners, to a decentralised system in which cash controls transactions. The traditional Chinese communist approach to development was for the state to supply enterprises with everything they required-- including free gifts of capital--and to absorb their entire output for distribution at fixed prices.

Today, the average enterprise has to find a great part of its own raw materials and other inputs and must search out its own market outlets for its products. The finance it needs both for investment and working capital has to be generated increasingly by its own trading. A severe shortage of free funds in the last two years has meant that new sources of finance have had to be created, with more attractive forms of investment to lure those with cash surpluses.

Now that the state allows successful enterprises to keep a substantial **share** of their own **profits** and to manage their own **investment** and welfare funds, individual factories, transport companies and commercial undertakings have a lot more **discretion** over the form in which they keep their monetary assets. Most important of all, claimed these People's Bank specialists, the banks themselves are no longer passive bookkeepers and paymasters for the state. They have to finance expansion of their own business through finding new sources of funds and expanding their deposit base. "The commanding role

of cash is the biggest change, a real revolution, in the Chinese economy of the last decade,' declared one central bank official.

Most of the business that developed around the new money markets during much of 1986 was inter-bank lending, with individual transactions averaging, apparently, about RMB10 million. These deals were funded by those local banks able to win subtantial deposits from major business concerns with large cash flows. With the liberalisation of the commercial sector of the economy, a massive demand has developed for trade finance. According to a People's Bank source, discounting bills of exchange has become "a record growth area for volume of business and source of revenue'. Local banks now have a considerable incentive to improve their cash management since the opportunity cost of idle funds is high.

Initially, there were some fears among Chinese bankers that the biggest plants and commercial enterprises would be reluctant to come to the market for funds on a commercial basis. The suspicion was that they would prefer to stick to the old ways by which the government provided finance on a low-cost or gift basis. "We have been relieved to find that these borrowers are turning to us,' stated a Tianjin Industrial and Commercial Bank executive. "They find the banks more reliable, and they are free to use the money in a strictly commercial way instead of in obedience to central directives.'

One well-known example of this trend is Shandong province, whose Shengli oilfield needed RMB250 million on a short-term basis. The local banks raised this sum, without any difficulty, from surplus deposits identified around Shandong.

The appetite for commercial borrowing has intensified in the last year. Enterprises throughout China are anxious to advance from straight bank loans to other forms of funding for their operations. "You have no idea how many local enterprises want to float shares or issue bonds,' said a senior Industrial and Commercial Bank source recently. "The attraction is what you might call "democracy': borrow the people's money and build up the local economy without waiting for Beijing's decrees.'

"It would be wrong to think that we have a western-style stock-market boom,' warned a Finance Ministry official. "All that is happening is an orderly development of a natural trend.' The number of stock exchanges set up in 1986 totalled five, with more cities expected to establish their own forums for share transactions this year. "There has been fast growth,' conceded the Finance Ministry source, "with a very large number of new issues. However, the total number of enterprises that have sold shares is still under 10,000, a very small fraction of China's 93,000 state-owned industrial enterprises and 360,000 large collectively owned enterprises.'

Share ownership (and bonds) has become respectable with the Chinese Communist Party almost by accident. In the post-1978 drive to remove the more radical forms of Maoism, a decision was made to revive the rural cooperatives. These institutions were based on village shareholders. As agriculture blossomed with a new-found freedom for the peasants to make economic decisions, villages started to establish factories and transport firms, many of which were financed by cooperative shareholdings.

The urban managers in the 1980s watched this trend with growing envy, and they have made every effort to win local Communist Party approval for similar experiments in the towns and cities. At first, share and bond issues were approved on a small scale. They have occurred mostly where workers have been willing to put their family savings into the firm, often in return for the promise of a first claim for their relatives on any new job. Direct investment has been seen to bring decent returns, and the demand for access to shares and bonds from the public at large mushroomed throughout 1985 and 1986.

The state has been cautious about giving general approval for Chinese undertakings to issue their own paper. One stumbling block has been the fear that the banking system would lost control over the money supply and its deployment. Another has been the fear of speculation, a mortal sin with committed Chinese Marxists.

Originally, the danger of speculation was avoided by not allowing shares to be sold except under stringent conditions. It was soon realised, however, that an unofficial market was emerging. Thus, during 1986, the authorities decided to legalise share trading in such major money-market centres as Shenyang, Shanghai, Guangzhou and Chongqing. "It will take time for us to let share prices be determined by supply and demand as you have in London or Hong Kong,' predicted a Finance Ministry official, "but you will definitely see shares and bonds become a major source of investment funds in 1987 with a lot less control of price movements.'

Most Chinese bankers appear happy with the trend towards direct financing of industry and commerce. "Our banks are used to providing long-term capital requirements, although they do not like it,' said a People's Bank economist.

"But we see more profits to be made from handling the share and bond business in years to come than just ordinary lending. Also we reduce the risk of losses to banks now that China has a bankruptcy law, and firms can be [liquidated] for the first time.'

Within the central bank, share markets are seen as an important weapon in the fight to boost the nation's savings. The People's Bank's guess is that a bare 5% of the country's nine million private businesses have opened deposit accounts with their local banks. Among the 800 million rural inhabitants, a very considerable portion of the new wealth created by the economic reform programme since 1978 has not been banked. The share or bond issued by a local business enterprise is regarded by senior bankers as the easiest means to lure this money back into the nation's investment pool.

So far, this type of business has been free of the scandals and frauds that have dogged so many other areas of the economy since 1984. Some bankers, especially in Guangdong province, have suggested privately that the public's enthusiasm for shares as opposed to bank savings deposits will evaporate after the first corporate collapse.

"It is only a matter of time, as we all should know from Hong Kong's experience,' said a banker in the provincial capital. "We lack experience in China of inspecting share issues and approving bonds or regulating the company's activities, so we can't hope to have a better record than Hong Kong.'

The People's Bank, at headquarters level, acknowledges that an urgent priority is an effective securities law. "We have been looking at this problem for a long time without success,' confessed a central bank official. "It is essential for healthy development of capital markets to formulate such legislation, but we can only manage to frame some interim regulations at present.'

Some of his colleagues, said the official, favour borrowing from United States or other foreign sources. "I don't think that a socialist country can do so, since we have to take all measures to prevent speculation or unhealthy profiteering. We forbid such bad practices in village markets; we must do the same in share markets.'

Another issue which worries some of the banking executives who have been involved in the development of the securities business in a number of Chinese cities is the complexity of shareholders' rights. Liaoning province has been used as a testing ground for joint-stock enterprises since 1985. Its Shenyang Machine Building Bureau was authorised to select two enterprises for conversion to joint-stock ownership. In addition to separate state and collective classes of shares, two types of individual shares were created. The shares bear interest at an annual rate of between 8 and 12%, depending on the type of share. Also, dividends are payable, based on a complicated formula.

Initial official accounts show a substantial improvement in production and profits as a result of the experiment. But the capital structure, as set out in one official report, looks as complex as an esoteric London note-issuance facility. Several Chinese bankers argue that share issues and bond flotations have to become much simpler if the public

is not to be misled.

The potential contribution of the capital markets to the country's development is enormous. In theory, according to many leading officials in the People's Bank and respected economists, most firms and businesses could be converted from state and collective ownership to joint-stock corporations.

Nevertheless there are still grave misgivings. It is extremely doubtful whether the Chinese Communist Party as a whole would support the extensive popularisation of share holding. Some financial specialists in Beijing regard the adoption of the joint-stock corporation as the ultimate economic reform. Their fear is that the reformers may be running out of time.

"The Chinese Communist Party will hold a national congress later this year, and Deng Xiaoping and Party general secretary Hu Yaobang may step down,' one senior Party cadre commented. "Who will guarantee that the economic reform process remains in favour then?' Last month, Hu resigned.

The indications are that the Chinese Communist Party would not seek to undo reforms that have already been adopted; yet its enthusiasm for more brave experiments could well be dampened if more veteran leaders withdraw from the political scene.

One tactic that the reformers are exploiting is to emphasise how capital markets and securities trading are essential ingredients of any modernisation programme. The public is fed a diet of reasonably factual articles in the official news madia about the role of these markets in Japan and the western world. The implication is that if these financial arrangements enabled rapid progress elsewhere in the world, China will have to follow suit, since its Marxist-Maoist strategy has not defeated national poverty.

"But we cannot to go too far in this direction,' admitted the same senior Party official. "We are a socialist country, which has suffered a lot from capitalism and imperialism; and we know very well capitalist countries have terrible problems of their own.'

Away from the capital, the cities which have established money markets and started fledgling share markets have far fewer reservations. "The only obstacle to 1987's growth of this side to our business is how many deals we can handle,' stated a Shanghai bank official. "We haven't the staff, and we lack experience; and yet our capital markets have grown wonderfully in the last two years.' What about the Chinese Communist Party's ideological misgivings? "The people want progress, the people want profits,' he replied, "and they are no longer so patient.'

Photo: From left to right--chairman Deng Xiaoping: may step down later in the year; president Chen Muhua of People's Bank: priority of an effective securities law; ex-general secretary Hu Yaobang resigned last month because of "mistakes'.

Photo: Western-style advertising in sophisticated Guangzhou, tipped to be China's future top money market.

Photo: The process of entering the lion's den of brave new experiments may be slowed down by political departures.

Captions: Central and eastern China. (map)

Special Features: illustration; map; photograph
Industry Codes/Names: INTL Business, International
Descriptors: Socialism--China; Industry and state--China; Economic development--China; Capitalism--China; Communism--China; China--Economic aspects
Geographic Codes: ANCC
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54/9/12 (Item 12 from file: 148)
01907232 Supplier Number: 02928200 (THIS IS THE FULL TEXT)
Reynolds Metals Co. announces sale of common stock by pension fund.

PR Newswire , NYPR55
Sept 20 , 1983
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Text:

RICHMOND, Va., Sept. 20 /PRNewswire/ -- Reynolds Metals Company announced today that it has filed a registration statement with the Securities and Exchange Commission for the anticipated sale of 1,062,000 shares of the company's common stock by its employee pension fund.

The pension trust fund acquired 600,000 shares of convertible preferred stock last year as part of the company's annual contribution to the fund. Reynolds said it has called for redemption of the preferred issue, which may be converted into 1,062,000 **shares** of the company's common stock and sold at the **discretion** of the pension **investment** manager. The company would receive no **proceeds**.

The Chase Manhattan Bank, N.A. is trustee of Reynolds Metals' employee pension plans master trust fund. Goldman, Sachs & Co. is the underwriter. /CONTACT -- Robert L. Shaffer of Reynolds Metals at 804-281-2965

Company Names: Reynolds Metals Co.--Securities
Industry Codes/Names: BUS Business, General
Descriptors: Metal industry--Securities
Product/Industry Names: 3300 PRIMARY METAL INDUSTRIES
Ticker Symbols: RLM
File Segment: NW File 649